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OVERSIGHT ON THE IMPLEMENTATION OF THE AGRICULTURAL CREDIT ACT OF 1987

HEARINGS

BEFORE THE

SUBCOMMITTEE ON AGRICULTURAL CREDIT

OF THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

THE IMPLEMENTATION OF THE AGRICULTURAL CREDIT ACT OF 1987

MAY 23, JUNE 16, AND SEPTEMBER 30, 1988

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CONTENTS

	Page
Hearings held on:	
May 23, 1988	1
June 16, 1988	155
September 30, 1988	595

MONDAY, MAY 23, 1988

OVERSIGHT ON THE IMPLEMENTATION OF THE AGRICULTURAL CREDIT ACT OF 1987—WITH RESPECT TO THE JACKSON FARM CREDIT DISTRICT

Leahy, Hon. Patrick J., a U.S. Senator from Vermont	2
Prepared statement	3
Boren, Hon. David L., a U.S. Senator from Oklahoma, opening statement	1
Heflin, Hon. Howell, a U.S. Senator from Alabama	4
Harkin, Hon. Tom, a U.S. Senator from Iowa	6
Prepared statement	8
Daschle, Hon. Thomas A., a U.S. Senator from South Dakota	11
Karnes, Hon. David K., a U.S. Senator from Nebraska	11
Prepared statement	14
Cochran, Hon. Thad, a U.S. Senator from Mississippi	20
Breaux, Hon. John B., a U.S. Senator from Louisiana	21

CHRONOLOGICAL LIST OF WITNESSES

Naylor, Frank W., Jr., Chairman, Farm Credit Administration Board, and Jim R. Billington and Marvin R. Duncan, Members, Farm Credit Administration Board, McLean, VA, joint statement of	23
Joint prepared statement and attachments	24
Financial Data—Federal Land Bank of Jackson	25
Breaux, Hon. John B., Hon. Thad Cochran, and Hon. Howell Heflin, letters of, dated June 10, 1988, to:	
Hon. Frank Naylor	26
Hon. Marvin Duncan	27
Hon. Jim R. Billington	28
Questions to Farm Credit Administration	29
For Chairman Naylor	32
For Mr. Duncan	34
For each of the FCA Board Members	34
"News-Star-World," Saturday, May 21, 1988, Monroe-West Monroe, Louisiana, article, "Regulators Close Jackson Land Bank," by Gaynell Terrell, Gannett News Service	35
Breaux, Hon. John B., letter of, dated June 28, 1988, to:	
Hon. Frank Naylor	37
Hon. Marvin Duncan	38
Questions from Senator Tom Daschle:	
For Frank Naylor	39
To Frank Naylor and Marvin Duncan	40
Responses to questions	41
Question 1 and response	41
Financial Data—Federal Land Bank of Jackson	41
Question 2 and response	42
Questions 3, 4, and 5 and responses	43
Questions 6, 7, and 8 and responses	44
Questions 9, 10, 11, and 12 and responses	45

Page

Naylor, Frank W., Jr., Chairman, Farm Credit Administration Board, and Jim R. Billington and Marvin R. Duncan, Members, Farm Credit Administration Board, McLean, VA, joint statement of—Continued
Question 13 and response 47
Question 15 and response 47
Question 25 and response 47
Question 14 and response 48
Questions 16, 17, and 18 and responses 50
Question 28 for Mr. Duncan and response 50
Question 29 for each of the FCA Board Members and response 50
Questions 19, 20, and 21 and responses 52
Question 22 53
Response to question 22 54
Question 23 for Chairman Naylor 54
Response to question 23 55
Questions 24 and 26 55
Responses to questions 24 and 26 56
Question 27 and response 56
Question 29 for each of the FCA Board Members and response 56
Questions from Senator Tom Daschle for Frank Naylor and response 57
Questions for Frank Naylor and Marvin Duncan and response 57
Order Appointing Receiver of the Federal Land Bank of Jackson, Mississippi and Federal Land Bank Association of Jackson, Mississippi 59
Breaux, Hon. John B., letter of, dated June 28, 1988 61
Questions from Senator Tom Daschle for Jim Billington 62
Response from Jim Billington 63
What happens on July 6 when you have a mandatory consolidation of the land bank and the FICB? 79
Thor, Eric P., president and chief executive officer, Farm Credit System Assistance Board 80
Prepared statement 86
Graph: Yield Spread: 6-mo FFCB and T-bill—Closing Bid Yields 98
Breaux, Hon. John B., Hon. Thad Cochran, and Hon. Howell Heflin, letter of, dated June 10, 1988 99
Questions to the Assistance Board 100
Letter of July 5, 1988, to Senators John Breaux, Thad Cochran, and Howell Heflin 102
Responses to the questions to the Assistance Board 103
Federal Intermediate Credit Bank of Jackson—Statement of Financial Condition as of March 31, 1988 110
Breaux, Hon. John B., letter of, dated June 28, 1988 111
Questions from Senator Tom Daschle for Eric Thor 112
Letter of July 18, 1988, to Hon. John Breaux 113
Response to Senator Tom Daschle 114
Exon, Hon. J. James, questioning of Eric P. Thor 123
Carson, Robert A., member, board of directors, First South Production Credit Association, Lambert, MS 125
Prepared statement 130
Waide, David, member, board of directors, Fifth District Farm Credit Board, West Point, MS 134
Prepared statement 136

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Boren, Hon. David L., letter of, dated May 24, 1988, to Mr. Frank Naylor 150
Boren, Hon. David L., letter of, dated June 7, 1988, to Hon. Frank Naylor 151
Naylor, Frank W., Jr., Chairman, Farm Credit Administration, letter of, dated July 21, 1988, response to letters of May 24 and June 7 152
Boren, Hon. David, L., refers to the letters of May 24 and June 7 and Mr. Naylor's response 204

THURSDAY, JUNE 16, 1988

OVERSIGHT ON THE IMPLEMENTATION OF THE AGRICULTURAL CREDIT ACT OF 1987—WITH RESPECT TO THE ENTIRE FARM CREDIT SYSTEM

Boren, Hon. David L., a U.S. Senator from Oklahoma, opening statement 155

Page

Daschle, Hon. Thomas A., a U.S. Senator from South Dakota 157
Conrad, Hon. Kent, a U.S. Senator from North Dakota 157
Harkin, Hon. Tom, a U.S. Senator from Iowa, prepared statement 159

CHRONOLOGICAL LIST OF WITNESSES

Naylor, Frank W., Jr., Chairman, Farm Credit Administration Board, McLean, VA 162
Prepared statement 164
Questions from Senator Thomas A. Daschle 168
Responses for Senator Boren on capital adequacy requirements and responses on restructuring and borrower's rights for Senator Daschle 169, 177
Duncan, Marvin R., Member, Farm Credit Administration Board, McLean, VA 178
Prepared statement 179
Billington, Jim R., Member, Farm Credit Administration Board, McLean, VA 181
Prepared statement 185
Boren, Hon. David L., Chairman, Subcommittee on Agricultural Credit, letter of, dated July 12, 1988, to Jim R. Billington 191
Questions from Senator Thomas A. Daschle 192
Responses 192
Response to the question: Were you aware, were the other Board members aware of this lawsuit at the time that you hired Mr. Watkins? 208
Response to restructuring: Parameters of Loan Workouts 212
Thor, Eric P., president and chief executive officer, Farm Credit System Assistance Board, Washington, DC 218
Prepared statement 223
Yield Spread: 6-mo FFCB and T-Bill—Closing Bid Yields, graph 232
Boren, Hon. David L., Chairman, Subcommittee on Agricultural Credit, letter of, dated July 12, 1988, to Eric Thor 233
Question from Senator Thomas A. Daschle 234
Letter of, dated July 25, 1988, to Hon. David L. Boren 235
Response to Senator Daschle 236
Exon, Hon. J. James, a U.S. Senator from Nebraska 244
Eberly, Sam, Chairman of the Board, the Farm Credit Council, accompanied by H. Brent Beesley, president and chief executive officer, Farm Credit Corporation of America 249
Prepared statement 253
Beesley, H. Brent, president and CEO, Farm Credit Corporation of America, prepared statement 262
1. Financial condition of the Farm Credit System as of March 31, 1988 263
2. Forecast of Farm Credit System financial condition for 1988 266
3. The Farm Credit System 1988–1989 business plan 268
4. Credit quality 270
5. Loan restructuring 271
6. Other property owned 271
7. Borrower rights 272
8. High-cost debt 273
9. Operating expenses 273
10. Loan pricing 274
11. Competition 275
12. Consolidation issues 276
13. Protection of borrower stock 277
14. Secondary mortgage market 278
15. Capitalization 278
16. Financial assistance 281
17. Jackson situation 283
18. Borrower insurance 284
19. Affirmative action 284
20. Tax treatment of loan loss reserves 284
21. Rural development 285
22. Technical corrections 285
Conclusion 285
Exhibit I:
Chart 1.—High risk assets 287
Chart 2.—Credit quality comparison percent acceptable loans to total loans 288

Page

Beesley, H. Brent, president and CEO, Farm Credit Corporation of America, prepared statement—Continued
Exhibit I—Continued
Chart 3.—Components of net loans at year-end 289
Chart 4.—High risk loans 290
Chart 5.—Loans 90 days or more past due and still accruing interest 291
Chart 6.—Composition of restructuring actions 292
Chart 7.—Number of loans restructured 293
Chart 8.—Volume of loans restructured 294
Chart 9.—Other property owned 295
Chart 10.—Operating expenses 296
Exhibit II: The Farm Credit System Business Plan 1988-1989:
I. 1987 in Review 299
II. Farm Credit System Mission Statement and Strategic Objectives 302
III. Assumptions 303
IV. Farm Credit System Business Plan 306
A. Business Plan Objectives 306
B. Business Plan Strategies 306
V. Appendix: Farm Credit System Key Indicators 322
Exhibit III:
Chart 1.—Farm Credit System Rate Comparisons Long-Term Loans 4th Quarter 1987 327
Chart 2.—Farm Credit System Rate Comparisons Long-Term Loans 1st Quarter 1988 328
Chart 3.—Farm Credit System Rate Comparisons Short-Term Loans 4th Quarter 1987 329
Chart 4.—Farm Credit System Rate Comparisons Short-Term Loans 1st Quarter 1988 330
Miscellaneous Tables:
Springfield Rate Comparisons 331
Baltimore Rate Comparisons 332
Columbia Rate Comparisons 333
Louisville Rate Comparisons 334
Jackson Rate Comparisons 335
St. Louis Rate Comparisons 336
St. Paul Rate Comparisons 337
Omaha Rate Comparisons 338
Wichita Rate Comparisons 339
Texas Rate Comparisons 340
Sacramento Rate Comparisons 341
Spokane Rate Comparisons 342
Arnold, Jasper H. III, senior vice president—credit, letter of, dated November 2, 1988, to Hon. David L. Boren, response to question on Farm Credit System foreclosure practices with distressed borrowers 343
Severens, Eugene, Center for Rural Affairs, Walthill, NE 350
Prepared statement 353
Attachment 1.—FCS Inventory Re-Sale Program 356
Attachment 2.—Memorandum of Understanding Between the Farm Credit Administration and the Farmers Home Administration Regarding the Demonstration Project for the Purchase of Farm Credit System Land 358
Attachment 3.—Richard E. Lyng, Secretary, letter of, dated April 20, 1988, to Hon. Ed Jones, response for request of a written statement addressing implementation of a 3-year "Demonstration Project for the Purchase of System Land" authorized in section 613(c) of the Agricultural Credit Act of 1987 360
Attachment 4.—"FCS sets big sale of land to partners—Legislative bill could halt deals," March 16, 1988, Star Tribune, by Sharon Schmickle, staff writer 362
Attachment 4.—Continued—"Farmland Investor Fair IV set March 23," Illinois Agri-News, March 11, 1988 363
Attachment 5.—"Demonstration Project" Technical Hang-up, Small Farm Advocate, Winter 1987-88 364
Bright, Susan, cochair, credit committee, National Save the Family Farm Coalition, Centerville, IN 366
Prepared statement 369

Page

Bright, Susan, cochair, credit committee, National Save the Family Farm Coalition, Centerville, IN—Continued
Bunting, Benny, president, National Save the Family Farm Coalition, letter of, dated June 11, 1988, to Anne E. Dewey, General Counsel, Farm Credit Administration, comments on the FCA proposed regulations published in the May 12 Federal Register 373
Boren, Hon. David L., Chairman, Subcommittee on Agricultural Credit, letter of, dated July 12, 1988, to Susan Bright, additional questions 384
Questions from Senator Thomas A. Daschle 385
Response 386
Massey, James T., executive director, Farmers' Legal Action Group, Inc., St. Paul, MN 388
Prepared statement 393
Attachments:
Comments on proposed rules 397
Position Paper 415
Foreclosure Costs/Restructure Cost Analysis 425
Index 427
Borrower Rights Under the Agricultural Credit Act of 1987—questions and answers 443
Waiver of Restructuring 465
Table of Days 466
Rights of First Refusal 467
Attachment—Right of First Refusal 471
Letter—re: Right of First Refusal 474
Boren, Hon. David L., Chairman, Subcommittee on Agricultural Credit, letter of, dated July 12, 1988, to Jim Massey, additional questions 477
Questions from Senator Thomas A. Daschle 478
Response and comments on proposed rules 479
Glenn, Max E., executive director, Oklahoma Conference of Churches, Oklahoma City, OK 485
Prepared statement 489
Exhibit 1.—Comments on FCA proposed regulations 494
Exhibit 2.—Ag-Link response to Oklahoma's rural crisis 513
Exhibit 3.—WAR—White Aryan Resistance—Heartland Division 515
Exhibit 4.—Tulsa World, Saturday, June 4, 1988, "Lenders Race to Foreclose on Farms Before Deadline," by Jim Myers, World Capitol Bureau . 517
Exhibit 5.—What the New Farm Credit Act can do for Oklahomans—a series of outreach workshops sponsored by the Ag-Link Coalition and coordinated by the Oklahoma Conference of Churches 518
Exhibit 6.—Letter, dated June 6, 1988, to Terry Gutschenritter, vice president of special credit, Farm Credit System, Wichita, KS 520
Strebeck, Clayton L., associate area agent (farm management), Louisiana Cooperative Extension Service, Alexandria, LA 521
Prepared statement 523
Boren, Hon. David L., Chairman, Subcommittee on Agricultural Credit, letter of, dated July 12, 1988, to Mr. Clayton L. Strebeck, additional questions 525
Questions from Senator Thomas A. Daschle 526
Response 527
Enclosure—exhibit I, re: Federal Land Bank No 529
Enclosure—copy of the Federal Land Bank of Jackson's Distressed Loan Restructuring Policy 531
Information requirements for restructuring distressed loans 537
Distressed Loan Restructuring Application 539
Financial Statement 543
Supporting Schedules 544
Trend Analysis Statement—Income and Expense 545
Obligation to Provide Future Financial Information 547
Credit and Employment Information 548
Debt Verification Authorization 550
Exhibit II—Cost of Restructure Worksheet and Cost of Foreclosure Worksheet 551
Exhibit III—Form Letter 553
Principal Reason(s) for Credit Review Committee Decision 554

Page

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Melcher, Hon. John, statement to accompany Gill testimony 559
Gill, Tim H., president, Montana Livestock Ag Credit, Inc., prepared statement 560
American Farm Bureau Federation, National Association of Wheat Growers, National Cattlemen's Association, National Corn Growers Association, National Cotton Council, National Pork Producers Council, letter of, dated June 16, 1988, comment on the implementation of the Agricultural Credit Act of 1987, Public Law 100-233 563
Thomas, Larry C., manager, Farm Credit Banks of St. Louis, letter of, dated April 20, 1988, Offer of Settlement 565
Resolution of the Board of Directors of Farm Credit Corporation of America—Loan Restructuring and Borrower Rights 567
Model Distressed Loan Restructuring Policy 569
Model District Board Resolution Loan Restructuring and Borrower Rights 576
Exon, Hon. J. James, U.S. Senator, letter of, dated May 20, 1988, request for legal interpretation 578
Severens, Gene, staff attorney, Center for Rural Affairs, Walthill, NE, letter of, dated May 10, 1988, to Senator J. James Exon, enclosure to May 20, 1988, letter 580
Attachments 1-7, to Gene Severens, staff attorney, Center for Rural Affairs, May 10 letter:
"Farm Credit president visits state, gives no word on Omaha assistance," by Dan Looker, Journal farm editor, Money, Lincoln, NE Journal, Thursday, March 24, 1988 584
Excerpt, letter, dated May 10, 1988, to John Martin, senior vice president, Farm Credit Services 585
"Demonstration Project" Technical Hang-up, Small Farm Advocate, Winter 1987-88 586
"FCS Inventory Re-Sale Program," Small Farm Advocate, Fall 1987 587
"Farm aid that isn't getting through," Chicago Tribune, May 6, 1988, Section 1, by Marty Strange 588
FmHA Demonstration Project, March 22, 1988 589
"Omaha Farm Credit's positive earnings first since '83," by Dan Looker, Journal farm editor, Money, Lincoln, NE Journal, Wednesday, May 11, 1988 590
Boren, Hon. David L., Chairman, Subcommittee on Agricultural Credit, letter of, dated May 25, 1988, to Hon. J. James Exon, reply to May 20, 1988, letter. 591

FRIDAY, SEPTEMBER 30, 1988

OVERSIGHT ON THE IMPLEMENTATION OF THE AGRICULTURAL CREDIT ACT OF 1987—WITH RESPECT TO THE FARMERS HOME ADMINISTRATION

Leahy, Hon. Patrick J., a U.S. Senator from Vermont 595
Boren, Hon. David L., a U.S. Senator from Oklahoma, opening statement 595, 597
Harkin, Hon. Tom, a U.S. Senator from Iowa 599
Material supplied for the record pertaining to surplus land and suitable land .. 601
Conrad, Hon. Kent, a U.S. Senator from North Dakota 602
FmHA Over 3-Year Delinquencies of Major Farm Program Direct Loans, June 30, 1987, appendix IV 604
Daschle, Hon. Thomas A., a U.S. Senator from South Dakota 606

CHRONOLOGICAL LIST OF WITNESSES

Clark, Vance L., Administrator, Farmers Home Administration 607
Prepared statement 611
Authority to compromise or adjust Indian Land Acquisition Act Loans 625
Background of FmHA field hearing officers 628
Sale of land, transfer, and assumption 632
Listing of transfers and assumptions from Oct. 1, 1987 to Aug. 31, 1988, by State 633
Annual Production Loans to Delinquent Borrowers 640
Harkin, Hon. Tom, U.S. Senator, letter of, dated Dec. 5, 1988, questions and responses from La Verne Ausman, Acting Administrator, letter of, dated Dec. 22, 1988 644

Page

Proposed Revisions to Provisions of the Supplemental Appropriations Act, 7 CFR Part 1941 658
Swenson, Leland H., president, National Farmers Union, Washington, DC 661
Prepared statement 665
Bunting, Benny, chair, credit committee, National Save the Family Farm Coalition, Oak City, NC 670
Prepared statement 676
Clark, Vance L., Administrator, Farmers Home Administration, letter of, dated June 27, 1988, to Benny Bunting, response to issues 682
"Small election becomes battleground on farm policy," by Susan Crittenden, Star special correspondent, Sunday, September 25, 1988, the Indianapolis Star 686
"Irregularity forces new Madison FmHA vote," by Dan Looker, Register agribusiness writer, the Des Moines Register, July 29, 1988 687
Massey, James T., executive director, Farmers' Legal Action Group, Inc., St. Paul, MN 688
Prepared statement 694

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

"U.S. FmHA chief says agency's money losing ways got to go," by Joanne M. Haas, UPI 1988, Madison, WI 707
Thompson, Micheal, Iowa Farmer/Creditor Mediation Service, Inc., Des Moines, IA, prepared statement 709
Blechman, Frank, Associate, The Conflict Clinic, Inc., letter of, dated September 29, 1988, to Hon. David L. Boren 712
Prepared statement 713

OVERSIGHT ON THE IMPLEMENTATION OF THE AGRICULTURAL CREDIT ACT OF 1987

With Respect to the Jackson Farm Credit District

MONDAY, MAY 23, 1988

U.S. SENATE,
SUBCOMMITTEE ON AGRICULTURAL CREDIT OF THE
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The subcommittee met, pursuant to notice, at 1:30 p.m., in room 332, Russell Senate Office Building, Hon. David L. Boren (chairman of the subcommittee) presiding.

Present or submitting a statement: Senators Leahy, Boren, Heflin, Harkin, Daschle, Breaux, Cochran, Boschwitz, and Karnes.

Also present: Senator Exon.

STATEMENT OF HON. DAVID L. BOREN, A U.S. SENATOR FROM OKLAHOMA

Senator BOREN. The hearing today will focus on the particular problems that have arisen in the 5th Farm Credit District of Jackson. This hearing comes at an opportune time, as the Farm Credit Administration, last Friday, appointed Mr. Ronald Watkins as receiver for the Federal land bank and the Federal Land Bank Association of Jackson.

The Farm Credit Administration appointed the receiver at the request of the Farm Credit System Assistance Board.

The development in Jackson is not surprising. We have known that the bank has been in serious difficulties for some time, but it should be stressed that this is a unique situation and in no way affects the prospects for the Farm Credit System Assistance Board to work in a positive way to help other institutions remain viable.

We want to assure everyone that the appointment of a receiver in Jackson will not affect the marketability of the Farm Credit System obligations. They are fully secured and the situation in Jackson should have no impact upon their marketability.

Additionally, this action should not have any effect on maturing System obligations as they are fully secured under the act.

I have also been assured that alternate arrangements will be made for the resumption of long-term lending in the Jackson District. This is very important, of course, to the farmers in that District.

We want to make sure that long-term credit is made available to them, and that the borrower needs are fully serviced in the Jack-

son District. We're all anxious to see this occur since no long-term loans have been made in the 5th District since last December.

In addition, borrower stock will be retired at par by the receiver as provided for under the Farm Credit Act. So, borrower stock of all those borrowers who are not in default will be fully protected.

Many unanswered questions remain at this point and we hope that today's hearing will begin to shed some light on the ramifications of the liquidation of the Federal land bank and the Federal Land Bank Association in Jackson.

I appreciate the willingness of all of our witnesses to be here today. Senator Breaux has talked to me over the past several weeks and, in particular, again with greater intensity, over the last several days about the situation in Jackson and had urged that we have this oversight hearing.

We're also privileged to be joined by the chairman of the full committee, Senator Leahy. Chairman Leahy is here with us today and, of course, he has had an intense interest not only in what has been going on this District but also in the way the system is functioning under the new farm credit legislation, which he helped to craft.

So, I would like to turn first to Chairman Leahy and ask for his opening comments and then to Senator Breaux.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

The CHAIRMAN. Thank you. I do want to thank you, as chairman of the subcommittee for having these hearings, and Senator Breaux for the involvement and willingness to have this hearing. It certainly appears to everyone here that the subject matter is timely when you consider the events of last Friday.

This subcommittee, and the Agriculture Committee as a whole, spent a great deal of time and effort last year to address the problems of the Farm Credit System. We are now beginning to see the fruits of that labor. This hearing is to receive testimony that this committee is concerned with and how the provisions of the Agricultural Credit Act of 1987 are being carried out. Mr. Chairman, I commend you, because I know you've scheduled a series of oversight hearings on other provisions of the act. I think it makes it very clear that last year we had the incentive to move before disaster struck, but we also said over and over again during that time that once having passed a new act, we were not going to ignore it.

The oversight function would continue extensively and these hearings are proof of that.

Now, questions will be asked. The appointment of a receiver last Friday at the Jackson Federal Land Bank brings up a series of questions. Will new loans be made? Who will make them? What will happen to the existing loans? When and how will the borrower's stock be retired? How will the July 6 merger take place and with whom? What did it cost to put Jackson into receivership and who will pay for it? All of these questions need to be addressed.

I also want assurances from the Farm Credit Administration that appointment of a receiver in Jackson will not cause an additional financial burden to fall on other districts in the System. The

Agricultural Credit Act of 1987 laid out clear guidelines for providing assistance, and for its funding by the Farm Credit System. Clearly, the Congress did not intend that joint and several liability be invoked routinely to cover the outstanding obligations of a troubled institution.

I am also deeply concerned that Friday's action does not cause the rights of borrowers in the Jackson District to be laid aside. The Congress spoke clearly in last year's farm credit bill on the issue of borrower rights. I can assure you that this committee will not allow the unusual action taken by the Farm Credit Administration regarding Jackson to be an excuse to circumvent the borrower rights provisions of the law nor would I expect anybody in the Farm Credit Administration to intend that. And I am sure they do not.

So, I would ask that the chairman leave the record open so that additional questions that arise from the current action in Jackson can be submitted over the next few weeks.

I appreciate the fact that the people from the Farm Credit Administration passed the word up to me in Vermont this was going on.

I am very concerned about this issue. Senator Breaux and Senator Boren I commend you again for having this hearing. I think that it's extremely important the subcommittee look at this issue. Thank you.

[The prepared statement of Senator Leahy follows:]

PREPARED STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

I would like to thank Senator Breaux for calling this hearing of the Subcommittee on Agricultural Credit to address the Jackson Farm Credit District situation. It certainly appears that the subject matter is timely given the events of last Friday.

This subcommittee and the Agriculture Committee as a whole spent a great deal of time and effort last year to address the problems of the Farm Credit System. We are now beginning to see the fruits of that labor. This hearing is testimony that this committee is concerned with how the provisions of the Agricultural Credit Act of 1987 are being carried out. I commend Subcommittee Chairman Boren for scheduling a series of oversight hearings on other provisions of the act.

The appointment of a receiver last Friday at the Jackson Federal Land Bank brings up a series of questions. Will new loans be made? Who will make them? What will happen to the existing loans? When and how will the borrower's stock be retired? How will the July 6th merger take place and with whom? How much did it cost to put Jackson into receivership and who will pay for it? All of these questions need to be addressed.

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I would ask that the chairman leave the record open so that additional questions that arise from the current action in Jackson can be submitted over the next few weeks.

Senator BOREN. Thank you very much, Chairman Leahy; we appreciate your interest. Again, as I said a moment ago, Senator

Breaux has been following this situation very very closely. He's very knowledgeable of the affairs in this district.

I note that we have been joined by Senator Boschwitz, who is the ranking member of this committee, and also by Senator Heflin who has very direct knowledge about the affairs of the Jackson District.

I have asked Senator Breaux, because of his knowledge of the district, if he would stand in and chair the hearing this afternoon.

I am also involved back and forth on the floor. Senator Breaux will chair the remainder of the hearing so the hearing can continue without interruption.

Senator Boschwitz, do you have any opening comments?

Senator BOSCHWITZ. No. The FCA spoke to me on Friday as I am sure they also spoke to you telling us of the imminence of this.

I read in the paper that it was a total surprise.

I wasn't totally surprised, Mr. Chairman. And I suppose no one else who has been observing the matters of that particular bank was totally surprised. I understand the bank is open and operating today. Is that correct?

Senator BOREN. Yes, that is correct.

Senator BOSCHWITZ. There will be a reorganization and resurgence of that bank so it can continue to do its function and job.

Senator BOREN. Thank you, Senator Boschwitz. I think we all share that hope. And we share the hope that this development will not only result in no interruption of service, but it will also enable us to go back to providing long-term agricultural credit to those in the Jackson District.

Because of the financial situation, they've not been able to really effectively provide long-term loans since last December.

Senator Heflin is a valued member of the Agriculture Committee and also very knowledgeable about this district. Senator Heflin, are there any comments that you would have?

STATEMENT OF HON. HOWELL HEFLIN, A U.S. SENATOR FROM ALABAMA

Senator HEFLIN. Mr. Chairman, I appreciate the opportunity to make a few statements. On Friday afternoon at 4:30 Alabama time, the Farm Credit Administration closed the doors and seized all the records and properties of the Federal Land Bank of Jackson, of which Alabama is a part.

Now, that something is finally taking place in regards to the Jackson Land Bank, I'm hopeful that we soon will see the restoration of long-term lending at competitive rates to the farmers in that area, the retirement of borrower stock and the implementation of the 1987 act.

I am sure that farmers throughout my home State of Alabama and Mississippi and Louisiana as well have a number of questions and hopefully we can get some answers at this hearing today.

It's no secret that the Jackson Land Bank has been facing serious economic difficulty for the past few years for three major reasons.

First, because of a bad agricultural situation in the last decade. A number of crop failures and the low price offered for agricultural commodities.

And, second, because of the decreasing land prices; and, third, many have suggested mismanagement at the Jackson District.

Nevertheless, I seriously question why in light of known economic instability faced by the Jackson District the Farm Credit Administration did not take action in this matter at an earlier date and use the authority provided them by Congress in the 1985 and 1986 Agriculture Credit Act Amendments to assist ailing Farm Credit System banks.

Indeed, on October 30, 1987, I said in a speech on the floor of the Senate, "Mr. President, simply put, Congress has given the Farm Credit Administration and the Secretary of the Treasury the authority and the tools to take remedial action and infuse capital into the Farm Credit System. I call upon them to exercise this authority and to make use of these tools."

Further, I said, in the same speech, "Although I understand the Farm Credit Administration considers the questions of certifying need of its assistance as early as May of 1987, they did nothing and through their inaction allowed the financial instability at the Jackson District to worsen to the point of no return."

And, finally, on December 1, 1987, I said, "Mr. President, the urgency and the severity of this system could have easily been defused had the Farm Credit Administration taken advantages of provisions passed by Congress."

Yet, no action was ever taken. And the situation was allowed to further deteriorate in the last 6 months, even though Congress passed and the President signed into law the Farm Credit System Assistance bill.

Since December of last year the Jackson Land Bank has effectively been closed in that the number of borrower stock has been frozen and no new loans have been made.

Partly because of this situation, the bank has been losing money at the rate of $4.7 million a month.

One question I have is why didn't the Farm Credit Administration and the Assistance Board implement the provisions of the 1987 act at an earlier date and assist the Jackson Land Bank, thereby preventing the loss of over $25 million?

As it now stands, because of the inaction of the Farm Credit Administration, the member borrowers of the Jackson Land Bank have been required to repay this lost money causing them additional, and in my judgment, unnecessary economic hardship.

Perhaps those who will be most acutely affected by the closure of the Jackson Land Bank will be those whose loans are delinquent or who are having the most trouble making their payments.

Had the Farm Credit Administration and the Secretary of the Treasury provided needed capital according to authority given to them by the provisions of the 1985 and 1986 Agriculture Credit Act Amendments, these loans could have been renegotiated.

The Jackson Land Bank would have received more of its payments and hundreds of farm families would not stand in jeopardy of losing their homes and their livelihood.

Mr. Chairman, one of the main purposes of this hearing today is to address the implementation of the 1987 Agricultural Credit Act Amendments.

In that regard, I am pleased that we are able to foresee some of the dangers presented by the potential failure of a System institution and provide protections in the 1987 act for the member borrowers.

I am particularly happy to see that the amendment I offered has adequately protected moneys by the members borrowers into uninsured voluntary or involuntary advance payment accounts.

As my amendment directed, moneys paid into such advance payment accounts will be credited against any outstanding indebtedness.

And there is no longer any danger that such payments would be lost or tied up for months in any transition period for the land bank.

In closing, Mr. Chairman, I am hopeful we can get some answers regarding what actions will be taken from this point forward in regards to the Jackson Land Bank to ensure that competitive long-term credit will be provided to farmers in that area in my State and also relative to other banking institutions that may be facing similar problems.

Senator BOREN. Thank you very much, Senator Heflin. We will be addressing, in the course of the day's hearing, some of the questions you have raised. And, again, I want to thank you for the contribution which you made when we worked on the farm credit legislation last year.

Those that are gathered here today had a great part in writing that bill and we hope that the provisions are going to be adequate to take care of these kinds of emergency situations.

And I think it's imperative that we closely examine this situation and make sure that that's the case, to see if there are any additional changes that need to be made.

By the way, this will just be the first hearing. Today, we're going to focus only on the problems of the Jackson District. But as I've mentioned to a number of members of the subcommittee, we do plan to have a comprehensive series of hearings on the implementation of the Farm Credit Act as members have suggested.

We do plan to have a comprehensive series of hearings by the subcommittee on oversight of the way that the bill is being implemented—both from the financial side, from the borrower's rights side, from the way the Assistance Board is functioning, the standards that have been adopted, and the rules and regulations that are being adopted.

Senator Harkin, do you have an opening statement?

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA

Senator HARKIN. Thank you, Mr. Chairman. I appreciate the opportunity to be here and I want to thank you for having this hearing for continuing oversight of the implementation of the farm credit bill.

Obviously, the situation with the Jackson Federal Land Bank demands our attention and a full hearing here with this subcommittee.

There is a problem arising now in the Omaha district that I think also warrants our attention. I understand this hearing concerns the Jackson Land Bank.

If that matter is fully disposed of today, however, I would hope that we might also get on with looking at what's happening out our way at the Omaha Federal Land Bank.

I wrote a letter to Mr. Thor and also to Mr. James Kirk, who is the president of Omaha Farm Credit Services, and I am sure my colleague, Senator Karnes, knows what I'm talking about.

The law is very unambiguous in that when the book value of a Farm Credit institution's stock falls below 75 percent of par value, certain provisions of the Agricultural Credit Act are triggered. The chief requirement is that the institution must request certification for assistance.

The Farm Credit Assistance Board must then come in and provide oversight and other assistance.

My information shows that the book value of the stock of the Omaha Federal Land Bank is way below 75 percent of par value and has been now, I think, since the first of the year and, yet, nothing is happening.

And the president of the Omaha Land Bank seems to think that he has discretion on the matter of requesting certification. Well, the law doesn't give discretion.

And I'm concerned about what the Farm Credit System is doing in the interim. Because if we aren't careful we could find the Omaha Land Bank, basically in the same situation as the Jackson Bank is in now, which would not be in the best interest of farmers or taxpayers.

I believe the provision of the law requiring a request for certification that we passed last year was carefully hammered out in a bipartisan fashion and it was put in there to do just that—to protect the stockholders and also to protect the taxpayers.

And, so, I say for the benefit of those who are here from the Farm Credit System that I will be following up on this.

And even though we may not be able to get to it today, I hope the Chairman will, again, allow us the opportunity to perhaps take a look at this at another time.

Senator BOREN. We certainly will. And you're exactly right that the provisions we wrote into the law were placed in the law in the hope that we would not wait until a situation deteriorated to the degree that it was beyond being saved.

And we wanted action to be taken early, feeling that the more quickly we could have assistance and appropriate supervision—that we would reduce costs in the long run to the taxpayers and we would have the greatest opportunity in keeping the system viable.

So, you're exactly right as to our intent and I think these are questions that are very appropriate to be addressed today as well.

Senator HARKIN. Thank you very much, Mr. Chairman.

[The prepared statement of Senator Harkin follows:]

STATEMENT OF SENATOR TOM HARKIN

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
SUBCOMMITTEE ON AGRICULTURAL CREDIT

OVERSIGHT HEARING ON IMPLEMENTATION OF CERTAIN PROVISIONS OF THE AGRICULTURAL CREDIT ACT OF 1987 IN THE JACKSON DISTRICT

MONDAY, MAY 23, 1988

Mr. Chairman, I welcome this opportunity to begin formally our oversight and review of the progress being made in implementing the Agricultural Credit Act of 1987. As you well know, we painstakingly crafted that momentous legislation in response to a national agricultural credit crisis that threatened to deepen and prolong the worst economic situation faced by our agricultural sector since the Depression years of the 1930's. The Act provides a sound statutory framework for rehabilitating and strengthening the sources of agricultural credit and for providing fair and reasonable treatment to borrowers while minimizing the costs to the federal government and taxpayers.

At this point, the success or failure of the Agricultural Credit Act depends primarily on the way in which its provisions are put into operation. I therefore look forward with great interest to receiving the testimony that will be provided at this series of oversight hearings on the implementation of the Act. Your scheduling of these hearings truly reflects your great interest and commitment to making the Act work so that our farm families and rural communities may have adequate amounts of credit on fair and reasonable terms.

Today's hearing, focusing on the problems that have arisen in the Jackson District, could not have been more timely. We were aware that problems existed in the Jackson District, but the situation plainly came to a head last Friday afternoon when the Farm Credit Administration Board declared the Federal Land Bank and the Federal Lank Bank Association of Jackson insolvent and appointed a receiver for the purpose of liquidation. The Jackson Bank is the first bank in the 72 year history of the Farm Credit System to be declared insolvent.

The situation in the Jackson District had obviously deteriorated seriously by the time the receiver was appointed on Friday. The Farm Credit System Assistance Board had previously authorized $30 million in assistance to the

Jackson Bank, yet the Bank had been losing an average of $4.7 million per month since the beginning of this year and had not written any new farm real estate loans for several months. Obviously, the Jackson Land Bank could not continue to operate in that manner. I believe, however, that the course of events in the Jackson District, culminating in the appointment of a receiver, raises a host of questions that we must examine carefully in order to ensure that the goals of the Agricultural Credit Act are achieved.

It appears that, at least prior to the appointment of the receiver, the Jackson Land Bank's situation differed from that of many other FCS institutions more in degree than in kind. We need to examine the circumstances leading up to the appointment of the receiver for the Jackson Land Bank to discern whatever we can that will help to prevent such a serious situation from developing at other Farm Credit System institutions in the future.

What conclusions can we draw about the timing and amount of assistance provided by the Assistance Board to the Jackson Bank, about the Assistance Board's role in supervising and providing management assistance to the Jackson Bank, and about the relative merits of liquidation as opposed to further assistance for the Jackson Bank and other institutions that may be in similar situations?

We are also concerned about the effects that appointment of the receiver will have on the borrowers of the Jackson Land Bank. It is essential that any arrangements that may be worked out regarding the assets of the Jackson Bank carefully protect the interests of these borrowers and recognize the future needs of borrowers in the area served by the Jackson Bank. It is especially important that borrowers receive cooperation and assistance in maintaining needed levels of financing in order to ease the transition to new operating arrangements.

Though today's hearing is focused on the Jackson District, I cannot help but note the implications and lessons from this situation that may apply in the case of the Omaha Federal Land Bank, which serves my state. We have a situation in the Omaha District where the book value of the Omaha Land Bank stock has been impaired to below 75 percent of the par value of the stock since the Agricultural Credit Act became law. Under section 6.4(b) of the Farm Credit Act, as amended by section 201 of the Agricultural Credit Act of 1987, when the book value of an institution's stock is below 75 percent of the stock's par value, "the institution shall request the Assistance Board to grant certification to issue

preferred stock under section 6.27(a)." Despite this clear, mandatory requirement, the Omaha Land Bank has not requested certification.

The matter of requesting certification is not a mere detail; it is of pivotal importance in the scheme of the Agricultural Credit Act of 1987. The request for certification brings oversight and supervision by the Assistance Board of the management of the institution in order to return the institution to a sound financial condition. The Act provided for such oversight and supervision to prevent further deterioration in the condition of the institution, thus avoiding greater cost to the taxpayers at a later time. Certification of an institution by the Assistance Board triggers special review of loans for debt restructuring and allows the institution to participate in the Demonstration Project for the sale of properties held in inventory by FCS institutions through reduced interest loans guaranteed by the Farmers Home Administration. This Demonstration Project provides significant land ownership opportunities for young and beginning farmers and should not be delayed.

I again wish to thank you, Mr. Chairman, for convening this important hearing and to thank the witnesses for appearing and submitting testimony.

Senator BOREN. Senator Daschle.

STATEMENT OF HON. THOMAS A. DASCHLE, A U.S. SENATOR FROM SOUTH DAKOTA

Senator DASCHLE. Mr. Chairman, I would join with Senator Harkin. I know that this hearing is specifically for the Jackson District and I think it's appropriate that it is. Obviously, that's where the most difficult problem may be at this point.

When I voted for the bill last December, however, this isn't what I had in mind. I didn't think that we would be here talking about receivership a few months into the authorization of this new act and I would really be interested in knowing from our testimony today what FCA and the Assistance Board has been doing in the last couple of months. Maybe there are good reasons why at least the apparent lack of oversight has brought us to this point.

But I think it's perhaps indicative of what may be happening elsewhere. The concern I have with regard to Omaha and certification may be rectified when they merge a little later on this year.

But we're going to be looking at this very carefully and we want to avoid another Jackson in Omaha and we're going to make darn sure that if we don't get the proper oversight from FCA and the Assistance Board, this subcommittee will have something to say about it.

And, obviously, with your leadership and that of the ranking member, we're going to do what we can here. And I appreciate the opportunity today.

Senator BOREN. Thank you, Senator Daschle. Senator Daschle is one of those that had brought the problems to my attention very early and suggested the comprehensive oversight hearings. And I thank him for that suggestion and we will follow through with it most certainly. Senator Karnes.

STATEMENT OF HON. DAVID K. KARNES, A U.S. SENATOR FROM NEBRASKA

Senator KARNES. Thank you, Mr. Chairman. I commend you and Senator Breaux and Senator Boschwitz, as well as Senator Leahy and Senator Lugar, for taking a particular interest in this very important issue. I am very pleased that the subcommittee is having the hearing today and as I have said before on many occasions, I believe this act is the most important piece of agriculture legislation passed in the 100th Congress. I know it is considered in that regard by many of the constituents in my State and by farmers throughout the country.

I note that the primary focus of today's hearing will be on the efforts that have been made to resolve the financial problems in the Farm Credit System Banks of Jackson, Mississippi. I hope that in reviewing the actions taken in the Jackson District that the subcommittee will be able to compare that approach with the financial assistance options taken or being considered throughout the system. In that way, the subcommittee can get an idea of the full range of options that are available for addressing problems in other districts, including the Omaha district, which, as Senator Harkin

has indicated, is of some concern to those of us in that area of the country.

I want to state at the outset that I have had the opportunity to deal on several occasions with Eric Thor, the chief executive officer of the Assistance Board, and I have been very impressed with his commitment and dedication to the job. I think he seems to have gotten off the mark well, although the problems have been very large. In my own district of Omaha, which may be a candidate for assistance, he has sought the input of farmers and ranchers all across the district for the first time, and they sincerely appreciate that interest on the part of the executive officer of the Assistance Board.

As I have said, the Omaha district may well be a candidate for certification and assistance under the act. However, I believe that it may be a bit too soon to know whether assistance will, in fact, be needed in Omaha. As mentioned, a merger between the Federal land bank and the Federal Intermediate Credit Bank in Omaha is required under the act by early July.

I support the position of the Assistance Board and the Omaha bank's executives and board that analysis of whether assistance is needed should be completed after the merger. I think that makes sound business sense.

I want to also point out that the act requires the banks, including the Omaha banks, to restructure loans where appropriate regardless of a bank's need for assistance. In these terms, I believe the Omaha bank has been very responsive in restructuring loans. If I were to learn that there was a problem with loan restructurings, I would be very concerned and ask that this subcommittee also look into the efforts to restructure loans. But at this point in time, I am not making that request.

One final point on certification of the Omaha district. I understand that it may be possible to work out some accommodation to allow for the implementation of a demonstration program for the sale of Farm Credit System land under certain provisions of the act. I hope that this can be considered, and I will be communicating with Eric Thor and the Assistance Board in that regard.

To summarize the situation in Omaha, I believe it's fair to say that the process, as far as I see, is working. The Assistance Board and the Omaha banks are in close communication. The merger of the Federal land bank and the Federal Intermediate Credit Bank is proceeding as required in the act, and analysis of the combined entity will be forthcoming.

As far as financial structure, as Senator Harkin indicated, we do have a problem with the 75 percent threshold, which I think needs to be taken into consideration after the required merger. In the meanwhile, I encourage the bank in Omaha to aggressively proceed with loan restructurings as I believe that they have.

I believe also that we must keep an important point in mind as we watch developments in Omaha. There will be no free ride if assistance is needed. The taxpayer will bear the burden of the interest cost during these early years, with a resulting budget impact. A large portion of the carrying costs of any assistance will have to be paid by farmers and ranchers who are current in their borrowing obligations.

And the entire amount of the assistance will have to be repaid by future generations of farmers, many young farmers, who, as I travel around the State, tell me, "I'm in good shape. I'm paying my debts. How come I have to assume part of this obligation?"

The Assistance Board of the Omaha banks are trying to fashion an approach that will provide assistance, if needed, yet minimize the amount of costs involved, particularly that burden that will be placed on farmers that are current in paying their debt. And I believe those farmers that have stuck with the System deserve the opportunity to see a solution worked out under the law.

Finally, I would like to address my attention to a recent action of the Farm Credit Administration Board in considering and then deferring proposed regulations covering the newly created Federal Agricultural Mortgage Corporation, or Farmer Mac. I believe it is important to correct an apparent misunderstanding by the FCA on what is expected of the agency in terms of its relationship with the Farmer Mac Corporation.

Congress has charged the FCA with examining the Mortgage Corporation on a regular basis. If unsafe or unsound practices are uncovered, those conditions are to be brought to the attention to Farmer Mac's management and board. In the event appropriate corrective action is not taken or the situation is of a nature as to require immediate attention, the agency has a broad and adequate range of administrative remedies under part C of title V of the act.

The authority of the Farm Credit Administration does not extend to adopting regulations governing the manner in which Farmer Mac shall conduct its business.

I took a leading role on this committee and in the subcommittee in fashioning the provisions dealing with Farmer Mac. I want to make it clear that the promulgation by the Farm Credit Administration of regulations covering the operations of the Mortgage Corporation, even regulations which merely mirror the provisions of the law, would be inconsistent with the language, and I believe the spirit intent of the language of section 8.11 of the act and the legislative history contained in the Senate and conference reports.

I expect the FCA to respect the approach that the committee has taken in the law and will confine agency initiatives with respect to the Mortgage Corporation to the examination and supervision activities that were contemplated.

Mr. Chairman, I look forward to the prepared statements of our witnesses today and appreciate them taking time out of their schedules to address this very important issue.

I have a full statement and I would like to have that reflected in the record if I may.

Senator BOREN. Thank you very much, Senator Karnes. Without objection, the prepared statement of Senator Karnes will be placed in the record in its entirety at this point.

[The prepared statement of Senator Karnes follows:]

STATEMENT OF SENATOR DAVID K. KARNES

HEARING BEFORE THE SUBCOMMITTEE ON CREDIT OF THE
SENATE COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY

MAY 23, 1988

Mr. Chairman, I commend you and Senator Boschwitz, as well as Senator Leahy and Senator Lugar, for calling this hearing for this afternoon. I am pleased that the Subcommittee is having this opportunity to get a preliminary reading of how the provisions of the Agricultural Credit Act of 1987 are being implemented. There is a great deal of interest on this in Nebraska.

I have said before that I believe that the Act is the most important piece of agricultural legislation passed by the 100th Congress. Our rural communities have been faced with tremendous problems and challenges. The circumstances required a flexible approach that recognized budget realities. The need to encourage the evolution of our nation's agricultural lending system into the 21st century presented the opportunity to establish a secondary market mechanism for agricultural real estate loans parallel to those which have been developed in residential housing and student loans. I am pleased to have worked with my colleagues on the Subcommittee and the Committee, and in the Conference, in crafting this historic legislation.

I want to thank our witnesses for being with us today. They have put considerable time and resources into preparing for this hearing. In addition, our witnesses from the Jackson district have come a considerable distance to be here to make know the views of farmers who will be impacted by the events. It is important that we have the value of their testimony and I extend special thanks to them for their efforts.

I note that the primary focus of today's hearing will be on efforts which have been made to resolve the financial problems facing the Farm Credit System Banks of Jackson, Mississippi. However, since this will be just one of several coming opportunities for this Subcommittee to assess how the Act is working, I believe it appropriate to raise several issues related to actions taken to implement the various provisions of the Act.

Looking beyond Jackson, I would point out that the Assistance Board has also put a financial assistance package into place in the Louisville district with the cooperation of the local district board and management of the FCS banks. The approach taken in Louisville is far less drastic than what seems to have been necessary in Jackson. I hope that in reviewing the actions taken in the Jackson district the Subcommittee will be able to compare that approach with the financial assistance options taken or being considered throughout the FCS. In that way, the Subcommittee can get an idea of the full range of options available for addressing problems in other districts, including the Omaha district.

I want to state at the outset that I have had the opportunity to deal with Mr. Eric Thor, the Chief Executive Officer of the FCS Assistance Board which we created under the Act. I have been very impressed with Mr. Thor. He seems to have "gotten off on the right foot". He has assembled a small, but well qualified staff. He has taken a studied and flexible approach to his responsibilities. He seems to work well with his board members, Secretaries Baker and Lyng, and he keeps his lines of communications to Congress open. In my district of Omaha, which may be a candidate for assistance, he has sought the input of farmers and ranchers across the district. I am pleased with what I have seen to date.

As I have said, the Omaha FCS district may well be a candidate for certification and assistance under the Act. However, I believe that it may be too soon to know whether assistance will in-fact be needed in Omaha. There has been some discussion of when the Omaha Federal Land Bank must request certification and assistance under the Act. The law gives the Assistance Board and the FCS banks considerable flexibility on

when certification is to be requested, and the method and timing of any assistance. I am comfortable that the Assistance Board and the management of the Omaha Banks are in close communication, and that there seems to be an atmosphere of cooperation. The Assistance Board and the Omaha district are trying to fashion a workable approach which will be in the best short-term and long-term interests of Nebraska farmers and ranchers.

A merger between the Federal Land Bank and the Federal Intermediate Credit Bank in Omaha is required under the Act by early July. I support the position of the Assistance Board and the Omaha Banks that an analysis of whether assistance is needed in Omaha should take the merger into account. Such an approach makes sound business sense. When the merger is taken into account, there will be a clearer picture of the financial strength of the combined entity. If the analysis then demonstrates that assistance is needed, the mechanism that we put in the law will operate as we intended.

I want to point out that the Act requires that FCS banks, including the Omaha Banks, restructure loans where appropriate, regardless of a bank's need for assistance. While it is true that the Act gives the Assistance Board added power to oversee and review restructuring where a bank gets assistance, banks that are not assisted are nevertheless required to proceed in good faith with loan restructurings. In terms of the Omaha FCS Banks, I am not aware that the restructuring requirements of the Act are not being taken seriously. If I were to learn that there is a problem with loan restructurings, I would be concerned and ask that this Subcommittee to look into the situation.

One final point on certification of the Omaha district. I understand that it may be possible to work-out some accomodation to allow for the establishment of the demonstration program for the sale of FCS land under the relevant provisions of the Act. This would enable the parties to go forward with an analysis of the need for assistance, yet facilitate the implementation of a worthwhile program for farmers. I will be communicating with the Assistance Board on this.

To summarize the situation in Omaha, I believe it is fair to say that the process is working. The Assistance Board and the Omaha banks are in close communication; the merger of the FLB and the FICB is proceeding as required; an analysis of the combined entity will be forthcoming; and the assistance mechanism will be available, if needed, as Congress intended. In the meanwhile, loan restructurings are proceeding.

I believe that we must keep an important point in mind as we watch developments in Omaha - there will be no "free ride" if assistance is needed. The taxpayer will bear the burden of interest costs during the early years, with the resulting budget impact. A large portion of the carrying costs of any assistance will have to be paid by farmers and ranchers who are current borrowers. The entire amount of the assistance will have to be repaid by future generations of farmers - young farmers who today are struggling to get started or stay in business. The Assistance Board and the Omaha banks are trying to fashion an approach that will provide assistance, if needed, yet minimize the amount and costs involved. I believe they deserve the chance to work-out a solution with our support.

I would like to raise another subject relating to the Omaha FCS district. The reimbusement of farmers and ranchers who held voting stock in the liquidated production credit association in O'Neill and Valentine, Nebraska is proceeding. The Assistance Board made the necessary funds available in a timely manner. The first round of reimbursements has been completed. At my request, the liquidating agent met with those farmers and ranchers whose claims remain outstanding. The Omaha FICB and the agent understand that if a borrower paid-off his or her loan in the full amount outstanding and also paid for the full par value of their stock, the borrower is entitled to, and will receive, reimbursement for the stock. By the same token, if the loan was not paid-off in full after the stock was applied to the loan at the full par value, the borrower is not entitled to any reimbursement.

On May 6, 1988, I was joined by Congresswoman Virginia Smith in a letter to the FCA asking that the agency conduct a special examination of the association estates and the FICB to determine whether the stock guaranty provisions of the Act have been complied with in O'Neill and Valentine. The Assistance Board and the Omaha FICB have made similar requests to the FCA. I expect that the FCA will conduct that examination soon, and that it will make a public report (separate from the examination report) available for distribution to the O"Neill and Valentine stockholders.

I want to mention another matter today concerning the guaranty of borrower stock. It concerns the pay-out of equities held by other financial institutions which have had discount relationships with FICBs. The Act clearly provides that the borrower stock guaranty provisions cover equities held by OFIs. Some FICBs may be hesitant to pay-out those equities to OFIs on a prompt basis. I would hope that rumors to that effect are not accurate. The Act requires that the FLB and the FICB in each district be merged by early July, 1988. As of today, the FICB in each district tends to be financially stronger than the FLB. I believe the pay-out of OFI equities should precede bank mergers. I note that Congress has provided a means for FCS banks to obtain funds from the Assistance Board if necessary to pay-out borrower equities, including those held by OFIs.

To delay the pay-out of equities held by OFIs premised on an exercise of district board discretion would be inequitable and, frankly, contrary to the intent of the Act. The prompt pay-out of FICB equities will enable OFIs to redeploy that capital to support lending to farmers, ranchers and small businesses in our rural communities.

Finally, I address my attention to the recent action of the FCA Board in considering, and then deferring, proposed regulations covering the newly created Federal Agricultural Mortgage Corporation. I believe that it is important to correct an apparent misunderstanding by the FCA on what is expected of the agency in terms of its relationship with the Mortgage Corporation.

The Act added to the law a new Title VIII which establishes the Mortgage Corporation and sets forth the provisions under which it is to conduct its operations. Section 8.11 of the title defines the relationship between the Mortgage Corporation and the FCA. The section authorizes the FCA to examine and supervise the performance of the powers, functions, and duties vested in the

Mortgage Corporation. The agency's authority is intentionally and specifically confined by the language of that section.

Congress has charged the FCA with examining the Mortgage Corporation on a regular basis. If unsafe or unsound practices are uncovered, those conditions are to be brought to the attention of the Mortgage Corporation's management and board. In the event appropriate corrective action is not taken or the situation is of a nature as to require immediate attention, the agency has a broad and adequate range of administrative remedies available under part C of title V of the law.

The authority of the FCA does not extend to adopting regulations governing the manner in which Farmer Mac shall conduct its business. The Act specifies the powers, functions, and duties vested in the Mortgage Corporation, and gives the board and the management of the Mortgage Corporation the necessary power to determine how they are to be exercised.

I took a leading role on this Committee and in the Conference in fashioning the provisions of the Act related to the Mortgage Corporation, including section 8.11. I want to make it clear that promulgation by the FCA of regulations covering the operations of the Mortgage Corporation, even regulations which merely mirror the provisions of the law, would be inconsistent with the language of section 8.11 and the legislative history contained in the Senate and the Conference Reports. The FCA will have ample opportunities to review the operations of the Mortgage Corporation at the appropriate time through the regular examination process and to take supervisory action necessary to protect the safety and soundness of that entity. I expect that the FCA will respect the approach that this Committee and Congress have taken, and will confine agency initiatives with respect to the Mortgage Corporation to examination and supervision activities.

Mr. Chairman, I look forward to the statements of our witnesses today and the answers they give to questions from Senators on the Subcommittee.

Thank you Mr. Chairman.

Senator BOREN. I would agree with you, Senator Karnes, in the statement you made earlier, in terms of regulatory authorities with Farmer Mac.

I think one of the things we want to focus on today is not only the manner in which the Jackson District's problems were handled, but we also want to use it as a case study and also as we look ahead to problems in Omaha and other districts and how they're being handled, to see whether or not there are any modifications that need to be made in the statutory language that we passed last year.

Anytime we pass a bill of that magnitude, there may be some unintended consequences. We know there are some technical corrections that need to be made in it.

That will be a focus, not only in this hearing, but also as we have our comprehensive oversight hearings.

We've also been joined by Senator Cochran, who played a very valuable role in working on the legislation last year. Of course, his State has been very much impacted by the decisions affecting the Jackson District.

Senator Cochran, we are very happy to have you with us today and we welcome any statement that you would like to make.

STATEMENT OF HON. THAD COCHRAN, A U.S. SENATOR FROM MISSISSIPPI

Senator COCHRAN. Thank you, Mr. Chairman. Let me express my appreciation to you as the chairman of the subcommittee for convening this hearing.

It is important for us to know some of the background of the decision to appoint the receiver in Jackson. I think it's also important for us to learn today, if we can, what happens next.

What is the plan of assistance that's going to be implemented and how are the borrowers going to be benefited by an assistance plan?

That, to me, should be the overriding concern as we look into the management and the implementation of the legislation that was passed last year.

So, that's what I'm interested in finding out from the witnesses who are scheduled to testify. I hope we can find out how the appointment of a receiver fits into this overall plan, and how is this going to benefit borrowers, those who are delinquent and those who are not, both now and in the future.

So, I appreciate again your recognizing me and hope we can have a good hearing today. I look forward to it.

Senator BOREN. Thank you very much, Senator Cochran. Now, I'm going to turn the gavel and the proceedings over to Senator Breaux so that he might preside in my place today.

As I said, Senator Breaux has taken the lead in preparations for the subcommittee to have this hearing today. He has been on top of the situation and developments in that district and I appreciate his interest in it and his continuing to follow it very very closely on a day-to-day basis and keeping me and others informed as to his findings.

Senator Breaux, I will turn the proceedings over to you at this point.

STATEMENT OF HON. JOHN B. BREAUX, A U.S. SENATOR FROM LOUISIANA

Senator BREAUX [presiding]. Thank you, Mr. Chairman. I thank you for agreeing to have the hearing. I certainly had no idea when we requested the oversight hearing that it would come in such a timely fashion.

I think that the events in Jackson on last Friday certainly give new meaning to the definition of the words "coincidence" and "timely."

So, we're very pleased that your leadership has allowed us to have the hearing and that you intend to follow up with other districts in similar fashion. We thank you very much for being so cooperative.

I would be, from the outset, very direct and say that what we're looking for today are some explanations and some assurances. Friday's actions in Jackson, I think, certainly necessitate it. Jackson District borrowers at the bank and at the association levels certainly deserve it.

The hearing will, as originally intended, review the implementation of certain provisions of the Agricultural Credit Act of 1987 with regard specifically to the Jackson 5th Farm Credit District. However, in light of Friday afternoon's events, we must do so under a different set of circumstances which exist in the Jackson Farm Credit District.

Appearing today are officials from the Farm Credit Administration, the Farm Credit System Assistance Board and Jackson Farm Credit District representatives.

We certainly thank each of them for being here. It's been a very difficult weekend. Our staff has been working over the weekend. I know, as well, for all the people appearing before us today, it was not easy for them to come to Washington. We appreciate those who have had to travel.

We seek from these witnesses specific information about resuming the long-term lending, retiring borrower stock and meeting debt obligations in a farm credit district whose land bank is now being liquidated.

We need to learn what the effects are of Friday's actions on the status and the operation of the Jackson Federal Intermediate Credit Bank and the First South and Northwest Louisiana Production Credit Associations.

With the July 6 mandatory land bank and FICB merger date approaching, we need to know in detail how this provision will be implemented with the FICB in a district whose land bank is in receivership.

Also critical will be information about the need for assistance in the Jackson District and how those provisions of the act would be implemented there with the land bank in receivership.

The Jackson Land Bank and its Association are affected by the denial of certification and the receivership decisions, but the magnitude and impact appear much greater than just that.

Information about the effect of these actions on joint management agreements and the shared housing in the same building of the land bank, the FICB, the First South PCA and the Bank for Cooperatives will be helpful to this subcommittee.

We want to hear the Assistance Board's reasons, including its cost-benefit analysis, to deny assistance and to recommend receivership, the reasons why the FCA appointed a receiver, including its own financial analysis, as well as their views on implementation of the 1987 act under these conditions in the Jackson Farm Credit District.

In December of last year, the Jackson Federal Land Bank reached zero net worth. Its working capital was exhausted. Its stock had no positive value.

Since then it has not retired stock and, just as critical, long-term loans have not been made.

In early February of this year the Federal Land Bank reportedly requested assistance certification. Two interim or temporary certifications totaling $30 million were made in late February and early May to the land bank for limited purposes.

No decision on a final long-term assistance certification was made until Friday, May 20, when certification was denied and receivership was recommended by the Assistance Board for the land bank.

The Farm Credit Administration, in announcing its decision to turn the Jackson Land Bank over to a receiver stated, in a release, that the bank "has lost an average of $4.7 million a month since the first of the year."

If the bank was losing money and it had reached zero net worth in December, we need to know why the FCA waited until now to decide on receivership as the course of action for the land bank.

If safety, soundness and prudence prompted Friday's action, what was the basis for the FCA not making that same determination earlier and avoiding even more losses?

A receiver is now in charge of the Jackson Land Bank. It is hoped more information will be provided by the FCA about its reasons for selecting him and the terms and the conditions of its agreement with him.

It will be important to know about the contract's effect on the immediate and future implementation of provisions for borrowers' rights, guaranteeing stock, long-term lending, making loan payments, restructuring loans, handling of bank and association joint management agreements and disposition of all properties.

A section of a news story which ran in a Louisiana paper on Saturday reported that an FCA spokesman said the Assistance Board notified FCA a month ago that it would no longer support the Jackson Bank.

We would like to receive comments on that section of the story from the FCA and the Assistance Board, particularly to understand why, if that notification did occur, it took another month to make a final decision, especially if the Jackson Bank had been losing money since January and had been at zero net worth since December.

I would like to know if a reference made in the same article to another FCA official about encouraging borrowers to seek alternative credit sources, if possible, was accurate.

If the article is accurate, I would like to know if it is the proper and prudent role of an official of the Federal agency which regulates the Farm Credit System to be encouraging System borrowers to seek alternative credit sources at a time when the Jackson District is trying to restore itself.

For land bank borrowers other information also is critical. To learn what will happen with their loans with the bank in receivership, what will happen to the borrowers' rights if and when loans are taken over by another institution, what other institutions would be eligible to take over these loans and how loan restructuring will be carried out will be helpful to know.

The ultimate purpose of today's hearing, I would simply say, is to try to get some answers and determine a direction as to where we go from here.

I think the timeliness of the hearing cannot be overstated.

We would like to welcome at this time our first panel and ask them to take their seats: the Honorable Frank Naylor, who, of course, is Chairman of the Farm Credit Administration Board; the Honorable Jim Billington, member of the Board; and, the Honorable Marvin Duncan, also a member of the Board.

Gentlemen, we welcome you here and we would be pleased to receive your opening statement.

JOINT STATEMENT OF FRANK W. NAYLOR, JR., CHAIRMAN, FARM CREDIT ADMINISTRATION BOARD, AND JIM R. BILLINGTON AND MARVIN R. DUNCAN, MEMBERS, FARM CREDIT ADMINISTRATION BOARD, McLEAN, VA

Mr. NAYLOR. Thank you, Senator, Chairman Boren, members of the committee. We have provided a joint statement on behalf of the Board, which is very brief, and if I may, Senator, I would simply bring it up to date as of today for the purposes of the committee and enter it in the record.

Senator BREAUX. Without objection, the joint statement of the Farm Credit Administration Board will be placed in the record in its entirety at this point.

[The joint prepared statement of the Farm Credit Administration Board and attachments follow:]

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STATEMENT BY THE FARM CREDIT ADMINISTRATION BOARD

FRANK W. NAYLOR, Jr., CHAIRMAN
MARVIN R. DUNCAN, MEMBER
JIM R. BILLINGTON, MEMBER

MR. CHAIRMAN, on May 20, 1988 the Farm Credit Administration (FCA) Board appointed REW, Inc., Ronald E. Watkins, President, as receiver for the Federal Land Bank and Federal Land Bank Association of Jackson, which serve Mississippi, Louisiana and Alabama. The action was taken by the FCA Board after the Farm Credit System Assistance Board (Assistance Board) requested that the FCA appoint a receiver for the Federal Land Bank of Jackson. At the same time FCA assured farmer/borrowers of the Jackson Federal Land Bank that credit service will be available in the three-state district.

As you know, Mr. Chairman, borrower stock is protected by the recently passed Agricultural Credit Act of 1987. Stock will be retired by the receiver with funds provided under that Act.

The Bank and 90 service locations were closed simultaneously at 4:30 p.m. (CDT) Friday, May 20, 1988 by the receiver and the Farm Credit Administration examination and supervision staff, with technical support from the Federal Deposit Insurance Corporation. Jackson Federal Land Bank facilities, under the management of the receiver, will be open during normal operating hours as soon as is practicable.

The Assistance Board had previously authorized $30 million to assist the Bank in meeting its obligations on securities issued to raise loan funds. The Farm Credit Act of 1971, as amended, provides mechanisms to assure that there will be no disruption in payment of principal and interest on the Bank's outstanding securities.

The FCA Board took steps to appoint a receiver when it determined that the assets of the Federal Land Bank and the Federal Land Bank Association of Jackson were less than their obligations to creditors and others, including farmer members.

The institutions have suffered severe dissipation of earnings and assets. The Federal Land Bank has lost an average of $4.7 million a month since the first of the year. It was also determined that the Bank was in an unsafe and unsound condition to conduct business.

This prudent action was taken in order to enable the Farm Credit System to continue to provide a full range of credit service to the borrowers in the three-state area. Because of the condition of the Jackson Federal Land Bank, no new farm real estate loans have been written for several months.

Mr. Chairman, that concludes the official FCA statement.

Financial Data--Federal Land Bank of Jackson, letters, questions, and responses follow:

Financial Data

Federal Land Bank of Jackson

	12/31/87	3/31/88
Amount of gross loans outstanding	$1.68 bil.	$1.56 bil.
Number of loans outstanding	21,771	21,391
Amount of non-accrual loans	$381.7 mil.	$330.4 mil.
Amount of high risk loans	$295 mil.	$309 mil.
Percentage of adversely classified loans to total loans	40 percent	39.2 percent
Net loan chargeoffs (chargeoffs net of recovery)	$37.7 mil.	* $11.2 mil.
Total assets	$2.002 bil.	$1.912 bil.
Total liabilities	$2.009 bil.	$1.909 bil.
Capital stock and participation certificates	$94.6 mil.	$118.7 mil.
Impaired stock	($101.9 mil.)	($115.1 mil.)
Total net worth	($6.3 mil.)	** ($3.6 mil.)
Total interest income (from loans & investments)	$168.0 mil.	* $40.2 mil.
Total interest expenses (cost of borrowed funds)	$213.3 mil.	* $48.9 mil.
Net interest income (expense)	($45.3 mil.)	* ($8.7 mil.)
Net income (loss)	($44.3 mil.)	* ($14.1 mil.)

* Indicates that data are for the quarter ended 3/31/88 and are not annualized.

** Improvement in the total net worth is due to the $30 million in financial assistance provided by the Farm Credit System Assistance Board earlier this year.

PATRICK J. LEAHY, VERMONT, CHAIRMAN

JOHN MELCHER, MONTANA
DAVID L. BOREN, OKLAHOMA
HOWELL HEFLIN, ALABAMA
TOM HARKIN, IOWA
KENT CONRAD, NORTH DAKOTA
WYCHE FOWLER, JR., GEORGIA
THOMAS A. DASCHLE, SOUTH DAKOTA
JOHN B. BREAUX, LOUISIANA

RICHARD G. LUGAR, INDIANA
ROBERT DOLE, KANSAS
JESSE HELMS, NORTH CAROLINA
THAD COCHRAN, MISSISSIPPI
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PETE WILSON, CALIFORNIA
DAVID R. KARNES, NEBRASKA

United States Senate

COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

June 10, 1988

The Honorable Frank Naylor
Chairman
Farm Credit Administration Board
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Mr. Naylor:

We appreciate your testifying before the Committee on May 23, 1988. Enclosed are additional questions which are being submitted to you and to the Farm Credit Administration Board for written answers. We would appreciate receiving your answers to the questions by July 1, 1988 so that the hearing record may be printed as soon as possible.

Thank you for your cooperation.

Sincerely,

JOHN BREAUX
Member
Subcommittee on
Agricultural Credit

THAD COCHRAN
Member
Subcommittee on
Agricultural Credit

HOWELL HEFLIN
Member
Committee on
Agriculture, Nutrition, and Forestry

PATRICK J. LEAHY, VERMONT, CHAIRMAN

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United States Senate

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WASHINGTON, DC 20510-6000

June 10, 1988

The Honorable Marvin Duncan
Member
Farm Credit Administration Board
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Mr. Duncan:

We appreciate your testifying before the Committee on May 23, 1988. Enclosed are additional questions which are being submitted to you for written answers. We would appreciate receiving your answers to the questions by July 1, 1988 so that the hearing record may be printed as soon as possible.

Thank you for your cooperation.

Sincerely,

JOHN BREAUX
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Subcommittee on
Agricultural Credit

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United States Senate

COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

June 10, 1988

The Honorable Jim R. Billington
Member
Farm Credit Administration Board
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Mr. Billington:

We appreciate your testifying before the Committee on May 23, 1988. Enclosed are additional questions which are being submitted to you for written answers. We would appreciate receiving your answers to the questions by July 1, 1988 so that the hearing record may be printed as soon as possible.

Thank you for your cooperation.

Sincerely,

JOHN BREAUX
Member
Subcommittee on
Agricultural Credit

THAD COCHRAN
Member
Subcommittee on
Agricultural Credit

HOWELL HEFLIN
Member
Committee on
Agriculture, Nutrition, and Forestry

QUESTIONS TO FARM CREDIT ADMINISTRATION

1) I assume that before taking such an extreme action as placing the Jackson bank in receivership, you have carefully analyzed the benefits, costs, and risks in taking such an action. What is your staff's estimate of the total cost of liquidating the Jackson Land Bank versus providing assistance through the Assistance Board?
A. I am requesting the FCA's estimates of costs of the Jackson liquidation. What is the responsiblity of the regulator under current law in establishing a receiver ?
B. What was the current complete financial status of the Federal Land Bank of Jackson? I am requesting a complete report.
C. Is it FCA's view that this was the least cost alternative for addressing the problems of this institution?

2) We are concerned that there be a smooth transition so that disruption of service to the borrower is kept at a minimum. What assurances can you provide us that the approach taken minimizes the disruption of services to borrowers, and particularly that the liquidation will not result in a "fire sale" approach and cause other borrowers to leave the system? Is there a targeted date for completion of the liquidation of the Federal Land Bank's assets?

3) The '87 Act put into place significant protections for Farm Credit borrowers. If a loan is sold or is in receivership, is it still subject to the same borrower rights provisions as if it were still held by a System institution?

4) When a loan is sold, what happens to the B stock held by the borrower? The '87 Act states that the borrower's investment in the System is protected. How will this be honored and who will be responsible for covering the costs associated with this protection?

5) Can you give us some information about the appointed receiver, Mr Watkins. Who is he? What qualifications does he have? How is he to be compensated? Has he had any relationship or understanding of the Farm Credit System? How many people does he have working for him?

6) Can you assure me that the farmers from my state will have a voice in the governance of whatever institution is established to serve their credit needs?

7) Why was the action to liquidate taken now, particularly since there was every indication that new management was aggressively developing a new assistance plan in the district?

8) How is the Federal Land Bank currently operating? I would like a complete account and explanation on the current status of operations at the bank, after the receiver was appointed.

9) Who or what institutions can buy Federal Land Bank loans or assets? Can these loans be sold to non-system institutions? Is such a sale probable? I would also request any legal basis for the sale of system loans to non system institutions?

10) From the regulator's view, how will assistance be given?

11) I would appreciate a complete explanation of your understanding of the assistance provisions of the Farm Credit Act of 1987.

12) Please explain your consideration of having state wide associations providing short term and long term credit services, as reorganization occurs. Please explain in detail the process to complete such a analysis, including advantages and disadvantages. Please give a priority listing of factors, you would consider in the process of reorganization of the district.

13. WITH REGARD TO FULL, PERMANENT BANKING SERVICES IN THE JACKSON DISTRICT, PLEASE:

A. IDENTIFY THOSE PERMANENT SERVICES WHICH WERE NOT PROVIDED IN THE JACKSON DISTRICT AND FOR WHAT LENGTH OF TIME;
B. EXPLAIN WHY THOSE SERVICES WERE HALTED;
C. IDENTIFY ANY PERMANENT SERVICES WHICH HAVE BEEN RESTORED IN THE JACKSON DISTRICT, WHEN THAT OCCURRED AND OF WHAT THE RESTORATION OF THOSE SERVICES CONSISTED;
D. IDENTIFY ANY PERMANENT SERVICES WHICH HAVE NOT BEEN RESTORED TO DATE, WHY RESTORATION OF PERMANENT SERVICE HAS NOT OCCURRED AND WHEN PERMANENT SERVICE WILL BE RESTORED.

14. SINCE THE HEARING ON MAY 23, SYSTEM INSTITUTIONS FROM TEXAS AND COLUMBIA HAVE SIGNED AGREEMENTS TO PROVIDE TEMPORARY LONGTERM LENDING SERVICES IN THE JACKSON DISTRICT. PLEASE EXPLAIN:

A. THE TERMS OF THOSE AGREEMENTS;
B. THE LENGTH OF TIME THEY WILL LAST;
C. IF BOTH BANKS WILL SERVE BORROWERS WHO APPLY FOR LONGTERM LOANS OR IF THEIR SERVICES WILL BE RESTRICTED ON A REGIONAL BASIS; IF THERE ARE REGIONAL SERVICE LIMITATIONS, PLEASE IDENTIFY OF WHAT THEY WILL CONSIST AND HOW THEY WILL OPERATE;
D. THE RIGHTS AND PROTECTIONS THAT JACKSON DISTRICT BORROWERS HAVE WHEN THEY ENTER INTO A LOAN AGREEMENT WITH EITHER THE TEXAS OR COLUMBIA LAND BANKS;
E. WHAT HAPPENS TO THESE LOANS ONCE A PERMANENT LAND BANK SERVICE IS RESTORED TO THE JACKSON DISTRICT;
F. IF THESE BORROWERS WILL BE ELIGIBLE TO VOTE AS STOCKHOLDERS IN THOSE DISTRICTS AFTER ENTERING INTO A LOAN AGREEMENT WITH THEM;
G. IF THESE BORROWERS WILL BE ABLE TO SERVE AS DIRECTORS ON THE BOARDS OF EITHER OF THOSE BANKS OR THEIR ASSOCIATIONS IF THEY HAVE ENTERED INTO A LOAN AGREEMENT WITH THEM;
H. IF THOSE BANKS WILL USE LOCAL EMPLOYEES FROM THE THREE-STATE JACKSON DISTRICT TO SERVE BORROWERS OR IF THEY WILL BRING IN EMPLOYEES FROM OUTSIDE THE THREE-STATE JACKSON DISTRICT TO SERVE JACKSON DISTRICT BORROWERS.

15. WITH REGARD TO RESTORING LONGTERM LENDING ON A PERMANENT BASIS TO THE JACKSON DISTRICT, PLEASE:

(A) LIST AND EXPLAIN ALL THE DIFFERENT OPTIONS WHICH ARE AVAILABLE TO BE CONSIDERED FOR RESTORING PERMANENTLY LONGTERM LENDING AT JACKSON;
B. IDENTIFY AND LIST THOSE OPTIONS NOW UNDER CONSIDERATION;
C. IDENTIFY AND EXPLAIN WHO WILL MAKE THE DECISION TO DEVELOP AND IMPLEMENT A PERMANENT LONGTERM LENDING AUTHORITY IN THE JACKSON DISTRICT AND WHY;
D. EXPLAIN IF THE FCA AND/OR THE RECEIVER ARE NOW IN CONTACT WITH OTHER SYSTEM DISTRICTS, SUCH AS TEXAS, COLUMBIA, OR LOUISVILLE, FOR ONE OR SEVERAL OF THEM TO SERVE AS THE PERMANENT FEDERAL LAND BANK IN THE JACKSON DISTRICT; IF SO, PLEASE PROVIDE ALL DOCUMENTS RELATING TO ANY SUCH DISCUSSIONS.

16. PLEASE EXPLAIN HOW THE FEDERAL LAND BANK BEING IN RECEIVERSHIP WILL AFFECT (A) THE JOINT MANAGEMENT AGREEMENTS IN EFFECT AT THE BANK AND ASSOCIATION LEVELS IN JACKSON AND (B) THE SHARED HOUSING AGREEMENTS IN EFFECT AT JACKSON.

17. PLEASE EXPLAIN HOW THE FINANCIAL STATUS OF THE FICB AND THE FIRST SOUTH AND NORTHWEST LOUISIANA PCA'S WILL BE AFFECTED BY THE JACKSON LAND BANK BEING IN RECEIVERSHIP.

18. IF SAFETY, SOUNDNESS, AND PRUDENCE PROMPTED THE FCA TO APPOINT A RECEIVER ON MAY 20, 1988, FOR THE JACKSON LAND BANK, IF THE BANK HAD BEEN AT ZERO NET WORTH SINCE DECEMBER AND WAS LOSING, ON THE AVERAGE, AN ESTIMATED $4.7 MILLION PER MONTH SINCE JANUARY 1988, IF SUPERVISORY ACTIONS BY FCA WERE NOT ABLE TO CORRECT LAND BANK PROBLEMS IN 1987, PLEASE EXPLAIN WHY THE FCA WAITED UNTIL MAY 20, 1988, TO PUT THE BANK INTO RECEIVERSHIP.

19. PLEASE EXPLAIN IF A NEWSPAPER ARTICLE'S REFERENCE TO A FCA REPRESENTATIVE ENCOURAGING JACKSON BORROWERS TO SEEK ALTERNATIVE SOURCES OF CREDIT IS CORRECT AND ACCURATE. IF IT IS, PLEASE EXPLAIN THE AUTHORITY FOR AND THE PROPRIETY AND PRUDENCE OF A REGULATORY AGENCY'S REPRESENTATIVE ENCOURAGING SYSTEM BORROWERS TO SEEK ALTERNATIVE CREDIT SOURCES, ESPECIALLY AT A TIME WHEN JACKSON IS TRYING TO RESTORE ITSELF AND THE 1987 ACT IS BEING IMPLEMENTED TO ASSIST THE SYSTEM AND ITS BORROWERS.(ARTICLE COPY ATTACHED)

20. WITH REGARD TO JURISDICTION OVER THE JACKSON FEDERAL LAND BANK RECEIVER, PLEASE EXPLAIN:

A. THE JURISDICTION AND POWERS THE FCA HAS OVER THE RECEIVER WHICH ARE SEPARATE AND DIFFERENT FROM THOSE OF THE ASSISTANCE BOARD BY VIRTUE OF THE BOARD'S ASSISTANCE CERTIFICATION;
B. ANY POTENTIAL OR ACTUAL PROBLEMS IN EXERCISING JURISDICTION OVER THE RECEIVER WHICH MAY NEED TO BE CLARIFIED OR CORRECTED DUE TO JURISDICTION OVER HIM BY THE FCA AND THE ASSISTANCE BOARD.

21. PLEASE IDENTIFY THE NUMBER OF JACKSON LAND BANK AND LAND BANK ASSOCIATION EMPLOYEES WHO ARE AFFECTED BY THE RECEIVERSHIP, HOW MANY ARE NOW EMPLOYED BY THE RECEIVER, HOW MANY WERE RELEASED FROM THEIR JOBS AND WHAT BENEFITS ARE RETAINED AND LOST BY THOSE EMPLOYEES WHOM THE RECEIVER HAS HIRED AND THOSE WHOM THE RECEIVER HAS RELEASED.

22. WITH REGARD TO THE JACKSON DISTRICT BANKS, PLEASE EXPLAIN:

A. IF AND WHEN, OVER THE PAST FIVE YEARS, THE FCA EXAMINED THE BANKS TO DETERMINE IF UNSAFE, UNSOUND OR IMPRUDENT BUSINESS AND MANAGEMENT PRACTICES WERE BEING USED;
B. THE NATURE OF THE UNSAFE, UNSOUND AND IMPRUDENT BUSINESS AND MANAGEMENT PRACTICES THE FCA DISCOVERED AS A RESULT OF ANY SUCH EXAMINATIONS;
C. WHAT STEPS THE FCA TOOK TO CORRECT THEM.

FOR CHAIRMAN NAYLOR:

23. PLEASE EXPLAIN WHAT THE PHRASE "LOANS IN PROCESS" MEANS IN YOUR STATEMENT " ...THE RECEIVER IS TO OBSERVE THE FULL FORCE AND EFFECT OF ALL THE BORROWER'S RIGHTS THAT ARE IN THE 1987 ACT, INCLUDING LOANS IN PROCESS."

24. YOU STATED, "AND WE WILL AFFORD THROUGH OUR RECEIVER FULL BORROWER'S RIGHTS AS PROVIDED UNDER THE LAW TO ALL PROBLEM BORROWERS OR LOANS THAT EXIST WITHIN THAT DISTRICT." PLEASE:

A. EXPLAIN HOW ALL THE BORROWER'S RIGHTS FOR JACKSON DISTRICT LAND BANK BORROWERS, I.E., THOSE WHOSE LOANS ARE (1) ACCRUING, (2) HIGH-RISK, (3) NON-ACCRUING, OR (4) IN FORECLOSURE WILL BE PROVIDED BY THE RECEIVER AS CALLED FOR THE IN THE 1987 ACT;
B. EXPLAIN HOW JACKSON LAND BANK BORROWERS WILL RETAIN ALL BORROWER'S RIGHTS ON THEIR LOANS IF AND WHEN THEIR LOANS ARE SOLD TO EITHER ANOTHER FARM CREDIT SYSTEM INSTITUTION OR TO A NON-FCS INSTITUTION;
C. LIST ALL THE "APPROPRIATE BORROWER'S RIGHTS", AS STATED IN YOUR TESTIMONY, WHICH WOULD BE ATTACHED TO JACKSON FLB LOANS SOLD BY THE RECEIVER.

25. YOU STATED THAT "ONE OF THE PRINCIPAL RESPONSIBILITIES FACED BY THE RECEIVER AND THE AGENCY IN THE NEAR TERM WILL BE TO TAKE APPROPRIATE STEPS TO ARRANGE FOR PERMANENT SERVICE TO BE RESTORED TO THAT DISTRICT...." PLEASE EXPLAIN:

A. "IN THE NEAR TERM" AND GIVE AN EXAMPLE OF WHAT YOU MEAN BY THIS;
B. THE PERMANENT SERVICE TO BE RESTORED;
C. WHAT WILL HAPPEN IN THE INTERIM UNTIL THIS PERMANENT SERVICE IS RESTORED;
D. WHY AND HOW THE RECEIVER WILL BE INVOLVED IN RESTORING PERMANENT SERVICE;
E. IF PERMANENT SERVICE WILL BE RESTORED PRIOR TO OR AFTER THE JULY 6 MANDATORY FLB/FICB MERGER DATE AND WHY.

26. YOU LISTED FOUR PROVISIONS IN YOUR TESTIMONY WHICH SUPPLEMENT, YOU STATED, THE FCA'S RECEIVERSHIP MANUAL AND CONSTITUTES THE ENTIRE AGREEMENT WITH THE RECEIVER. PLEASE:

A. EXPLAIN IF ALL SYSTEM AND NON-SYSTEM INSTITUTIONS WHICH PURCHASE LOAN ASSETS FROM THE JACKSON FLB RECEIVER ALSO HAVE TO COMPLY WITH CURRENTLY AND FUTURE PROPOSED FCA REGULATIONS REGARDING (1) BORROWER RIGHTS; (2) SEC. 4.14(A), REGARDING LOANS IN PROCESS, FORECLOSURE AND ON WHICH A JUDGMENT HASN'T BEEN RENDERED; AND (3) SEC. 4.36, REGARDING PROPERTY IN INVENTORY ON JANUARY 6, 1988 AND ANY PROPERTY ACQUIRED THEREAFTER;
B. EXPLAIN IF THE RECEIVER, UNDER THE TERMS OF HIS FCA AGREEMENT, HAS TO COMPLY WITH ALL CURRENTLY AND FUTURE PROPOSED FCA REGULATIONS TO IMPLEMENT THE 1987 AGRICULTURAL CREDIT ACT;
C. IDENTIFY THE OTHER APPLICABLE SECTIONS OF THE 1971 FARM CREDIT ACT, AS AMENDED, INCLUDING THE 1987 ACT AMENDMENTS, WITH WHICH NON-SYSTEM INSTITUTIONS MUST COMPLY IF THEY PURCHASE ASSETS FROM THE JACKSON FLB RECEIVER;
D. IDENTIFY AND EXPLAIN OTHER PROVISIONS OF THE FCA'S RECEIVERSHIP MANUAL WITH WHICH THE JACKSON FLB RECEIVER MUST COMPLY AND WHICH CONSTITUTE THE FCA'S AGREEMENT WITH THE RECEIVER;
E. PROVIDE A COPY OF THE FCA'S RECEIVERSHIP MANUAL;
F. EXPLAIN IF THE FOUR SUPPLEMENTARY PROVISIONS LISTED IN YOUR TESTIMONY ALSO WILL APPLY TO ANY FUTURE RECEIVERSHIP APPOINTMENTS WITHIN THE FARM CREDIT SYSTEM WHICH MIGHT BE MADE BY THE FCA.

27. YOU STATED IN YOUR TESTIMONY "...THE FEDERAL LAND BANK IN RECEIVERSHIP IS NOT AN ELIGIBLE UNIT ANY LONGER." PLEASE EXPLAIN (1) THAT STATEMENT IN LIGHT OF FCA REGULATION 12CFR 611.1176, "FINAL DISCHARGE AND RELEASE OF RECEIVER," IN PARTICULAR ITS FIRST SENTENCE, (2) WHY THE JACKSON LAND BANK IN RECEIVERSHIP IS NOT ELIGIBLE TO BE MERGED UNDER THE 1987 ACT'S MANDATORY FLB/FICB MERGER PROVISIONS, AND (3) HOW THE MANDATORY FLB/FICB MERGER PROVISIONS OF THE 1987 ACT WILL BE IMPLEMENTED IN THE JACKSON DISTRICT WITH THE FEDERAL LAND BANK IN RECEIVERSHIP.

FOR MR. DUNCAN:

28. PLEASE EXPLAIN HOW THE 1987 SUPERVISORY ARRANGEMENTS TO WHICH YOU REFERRED IN YOUR TESTIMONY WERE CARRIED OUT AND WHY THE PROBLEMS, AS YOU STATED, "...DID NOT GET CORRECTED IN A SATISFACTORY FASHION AND WITH THE SUPERVISORY ACTIONS IN PLACE--INDEED THE PROBLEMS CONTINUED...."

FOR EACH OF THE FCA BOARD MEMBERS:

29. REGARDLESS OF WHAT LEGISLATIVE ACTIONS THE CONGRESS WAS CONSIDERING IN 1987, THOSE CONSIDERATIONS IN NO WAY INTERFERED WITH NOR OBVIATED THE FCA'S STATUTORY RESPONSIBILITY TO ENSURE THAT SAFE, SOUND AND PRUDENT PRACTICES WERE BEING IMPLEMENTED BY THE JACKSON LAND BANK. PLEASE EXPLAIN WHY THE FCA DID NOT TAKE FURTHER APPROPRIATE REGULATORY ACTION IN 1987 WITHIN ITS EXISTING POWERS AT THE JACKSON LAND BANK IF, AS MR. DUNCAN STATED, PROBLEMS WERE OCCURRING, SUPERVISORY ACTIONS WERE TAKEN, BUT "...WITH THE SUPERVISORY ACTIONS IN PLACE--INDEED THE PROBLEMS CONTINUED...."

Newspaper article, "Regulators Close Jackson Land Bank" referred to in question 19 follows:

News-Star-World

Saturday, May 21, 1988 — Monroe-West Monroe, Louisiana — ★35 cents

MAY 23 '88 08:21 MON LH

Regulators close Jackson Land Bank

Uncollectable loans total over $646 million

By GAYNELL TERRELL
Gannett News Service

JACKSON, Miss. — Regulatory officials closed the Federal Land Bank of Jackson on Friday and appointed a receiver to clean up a mess that includes more than $646 million in risky or uncollectable loans.

But federal officials were quick to assure borrowers that the action will ultimately strengthen the bank, which has been losing $4.7 million a month since January. No farm loans have been made in several months.

At a news conference here, Michael J. Powers, chief regulator for the federal Farm Credit Administration, said the bank would reopen "under normal operations as soon as practical."

About 100 FCA and Federal Deposit Insurance Corp. examiners are working around the clock this weekend to begin liquidating uncollectable loans, collect debt and institute other cost-recovering measures.

The Jackson Land Bank is one of 12 in the Farm Credit System, a network of cooperatives that makes long-term loans to farmers and holds a third of the nation's farm loans. The system, which has been forced to seek financial help from Congress, holds about $55 billion in loans.

The Jackson district has $1.6 billion in outstanding loans to 21,771 borrowers. It operates 90 offices in Mississippi, Louisiana and Alabama. All were closed simultaneously Friday by a task force of more than 250 federal regulators.

Appointed as receiver was Ronald E. Watkins of Tulsa. Mr. Watkins is an former commercial banker who runs a consulting firm for failing banks. He has no previous ties to the Land Bank or the federal agency that oversees it.

On Monday, the Land Bank will begin repayment of $5 million in borrower stock that was frozen when bank finances became critical. Borrowers buy "stock" in the bank at 5 to 10 percent of their loan amount as a condition of obtaining the loans, making them stockholders in the bank. The money is recovered when the loan is repaid.

Powers said the land bank will sell off second loans to other lenders at market rates. Borrowers will be notified if the loan is transferred to another lender.

He encouraged borrowers to seek alternative credit sources if possible.

The Jackson Land Bank has reported losses of $4.8 billion during the last two years. It had earlier received a $30 million bailout from the Farm Credit Administration Assistance Board and reportedly was broke.

Bill Hendrix, an FCA spokesman in Washington, said the board notified FCA a month ago that it would no longer support the Jackson bank.

Hendrix said some employees may be laid off, but "It's up to the receiver how many of these branches he opens."

U.S. Rep. Jerry Huckaby, D-Ringgold, blamed the closure on crop failures in the district in re-

See LAND BANK, page 2A

Land bank

From page 1A

cent years, falling land prices and mismanagement on the part of land bank officials.

He said he was surprised that FCA closed the bank rather than merge it with another district or other alternatives.

"FCA went farther than I thought they would and faster than I thought they would. I thought they could have worked something out," Huckaby said.

U.S. Rep. Jamie Whitten, D-Miss., said the bank's closing was unfortunate, "but at least we got some movement.

"There is no question that they had a world of debts that were uncollectable. I think the bank closed itself. We in Congress had been trying to get something done and this is the only thing we could get," Whitten said.

FCA spokesman Ron Erickson said arrangements are being made with federal land banks in Columbia, S.C., and Austin, Texas, to provide credit.

"We are right now arranging for one or more ... districts to buy performing loans," Erickson said.

U.S. Sen. John Breaux, D-La., said he will address the problem in a committee hearing he will hold on Monday.

"As a member of the Senate Agriculture Committee, I am determined to ensure that this receivership protects Jackson Land Bank borrowers," Breaux said.

PATRICK J. LEAHY, VERMONT, CHAIRMAN

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United States Senate

COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

June 28, 1988

The Honorable Frank Naylor
Chairman
Farm Credit Administration Board
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Mr. Naylor:

We appreciate your testifying before the Committee on May 23, 1988. Enclosed are additional questions which are being submitted to you for written answers. We would appreciate receiving your answers to the questions by July 19, 1988 so that the hearing record may be printed as soon as possible.

Thank you for your cooperation.

Sincerely,

John Breaux

JOHN BREAUX
Member
Subcommittee on
Agricultural Credit

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WASHINGTON, DC 20510-6000

June 28, 1988

The Honorable Marvin Duncan
Member
Farm Credit Administration Board
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Mr. Duncan:

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Thank you for your cooperation.

Sincerely,

John Breaux

JOHN BREAUX
Member
Subcommittee on
Agricultural Credit

QUESTIONS FROM SENATOR TOM DASCHLE

Hearing on implementation of Ag Credit Act of 1987
in the Jackson District
May 23, 1988

FOR FRANK NAYLOR:

If the Chairman would indulge me, I'd like to explore a little further FCA's thoughts on the Omaha Situation. What jeopardy has the Omaha District placed itself in by not applying for certificiation. Would this effect any adverse action they have taken?

What would the impact of this new status have on the other disticts. It seems that this could undermine confidence in already potentially explosive situation?

QUESTIONS FROM SENATOR TOM DASCHLE

Hearing on implementation of Ag Credit Act of 1987
in the Jackson District
May 23, 1988

TO FRANK NAYLOR, AND MARVIN DUNCAN

Placing the Jackson Federal Land Bank into recievorship has certainly opened a lot of eyes. As I am sure you can understand, I am concerned also about the Omaha Land Bank. I don't believe the situation is as bad in Omaha, but none the less, I am concerned.

As you know we have had a public exchange this past week in the Omaha District over certification for assistance. On the one hand, the Bank say it really doesn't need certification because they'' be above the 75% stock level after the July 6 merger. Others say certification and oversight are long past due. And though it all, no one seems to "want the responsibility for determining that receivorship should occurr". It makes me wonder, whose watiching the store? Given the situation in Omaha, I ask that the board refresh all of us on the sequence of events leading to certification of Jackson and what parallels can be made to Omaha. Specifically, what role did FCA play in certification of Jackson, how much cordination and communicaiton actually took place?

Questions to Farm Credit Administration by Senate Committee on Agriculture, Nutrition, and Forestry.

Question 1. I assume that before taking such an extreme action as placing the Jackson bank in receivership, you have carefully analyzed the benefits, costs, and risks in taking such an action. What is your staff's estimate of the total cost of liquidating the Jackson Land Bank versus providing assistance through the Assistance Board?

A. I am requesting the FCA's estimates of costs of the Jackson liquidation. What is the responsibility of the regulator under current law in establishing a receiver?
B. What was the current complete financial status of the Federal Land Bank of Jackson? I am requesting a complete report.
C. Is it FCA's view that this was the least cost alternative for addressing the problems of this institution?

Answer 1. The statutory responsibility for analyzing the eligibility of System institutions applying for assistance and for determining the least cost means of financial assistance rests with the Farm Credit System Assistance Board (Assistance Board). Nevertheless, FCA staff continues to evaluate the condition and prospects of each troubled institution as quarterly performance data are received. FCA's analyses of the Federal Land Bank of Jackson repeatedly reflected differences between the cost of liquidation and that of assistance substantially in line with those expressed by the Assistance Board during Senate hearings held on May 23. The cost to return the bank to viability would have been very high, and potentially open-ended. It is the FCA's view that the closure of the Jackson bank was by far the least costly solution.

FCA has the authority to appoint a receiver when one or more statutory criteria for such appointment have been met. Section 4.12 (b) of the Farm Credit Act establishes these criteria which include, among others: insolvency, substantial dissipation of assets or earnings, or unsafe or unsound condition to transact business. Once the Financial Assistance Board determined that assistance would not be provided, appointment of a receiver remained the only realistic option to the FCA.

The following is a summary of the financial condition of the FLB of Jackson prior to the appointment of the receiver.

Financial Data

Federal Land Bank of Jackson

	12/31/87	3/31/88
Amount of gross loans outstanding	$1.68 bil.	$1.56 bil.
Number of loans outstanding	21,771	21,391

Amount of non-accrual loans	$381.7 mil.	$330.4 mil.
Amount of high risk loans	$295 mil.	$309 mil.
Percentage of adversely classified loans to total loans	40 percent	39.2 percent
Net loan chargeoffs (chargeoffs net of recovery)	$37.7 mil.	* $11.2 mil.
Total assets	$2.002 bil.	$1.912 bil.
Total liabilities	$2.009 bil.	$1.909 bil.
Capital stock and participation certificates	$94.6 mil.	$118.7 mil.
Impaired stock	($101.9 mil.)	($115.1 mil.)
Total net worth	($6.3 mil.)	** $3.6 mil.
Total interest income (from loans & investments)	$168.0 mil.	* $40.2 mil.
Total interest expenses (cost of borrowed funds)	$213.3 mil.	* $48.9 mil.
Net interest income (expense)	($45.3 mil.)	* ($8.7 mil.)
Net income (loss)	($44.3 mil.)	* ($14.1 mil.)

* Indicates that data are for the quarter ended 3/31/88 and are not annualized.

** Improvement in the total net worth is due to the $30 million in financial assistance provided by the Farm Credit System Assistance Board earlier this year.

Question 2. We are concerned that there be a smooth transition so that disruption of service to the borrower is kept at a minimum. What assurances can you provide us that the approach taken minimizes the disruption of services to borrowers, and particularly that the liquidation will not result in a "fire sale" approach and cause other borrowers to leave the system? Is there a targeted date for completion of the liquidation of the Federal Land Bank's assets?

Answer 2. The appointment of a receiver for the FLB of Jackson and the arrangements for new lending services reached with neighboring districts represent a restoration, rather than a disruption, of service to borrowers. As part of the initial phase of the liquidation, borrowers were immediately notified by letter of the appointment of a receiver, and that arrangements were being made with other System land banks to provide service for new loans to eligible borrowers. Local offices remained open to answer questions and assist borrowers. Outstanding loan balances remain with the receiver until the possible sale by the receiver.

In the event of a sale of a loan, all rights, privileges and duties would transfer with the loan. The only difference that should be noted by the

borrowers would be where and to whom they would make their scheduled payments. Additional information in this regard is provided below in response to questions 13, 14, 15 and 25. Your concern that the liquidation not result in a "fire sale" of assets is addressed in the response to question 5 regarding compensation for the receiver. While there is no target date for completion of the liquidation it is anticipated that the receivership will proceed expeditiously.

Question 3. The 1987 Act put into place significant protections for Farm Credit borrowers. If a loan is sold or is in receivership, is it still subject to the same borrower rights provisions as if it were still held by a System institution?

Answer 3. Yes. For example, the FCA is requiring that any sale of loan assets by the receiver of the Jackson FLB to a non-System institution must be conditioned on an agreement by the purchaser to comply fully with the borrower rights provisions of the Farm Credit Act of 1971, as amended.

Question 4. When a loan is sold, what happens to the B stock held by the borrower? The '87 Act states that the borrower's investment in the System is protected. How will this be honored and who will be responsible for covering the costs associated with this protection?

Answer 4. Mechanisms will be developed governing the treatment of stock in connection with sale of loans by the receivership which will ensure, among other things, that the protection of eligible borrower stock under section 4.9A of the Act is effectively implemented.

Question 5. Can you give us some information about the appointed receiver, Mr. Watkins. Who is he? What qualifications does he have? How is he to be compensated? Has he had any relationship or understanding of the Farm Credit System? How many people does he have working for him?

Answer 5. When appointed, Mr. Watkins was the owner and president of REW Enterprises, Inc., an Oklahoma corporation formed in 1980. He has functioned as an advisor to banks and bank holding companies concerning correction of both credit and financial problems. He has served as interim president, consultant and credit workout specialist in many problem situations, including having managed a portion of the portfolio administered by the Farm Credit System Capital Corporation prior to its dissolution in accordance with the 1987 Act. Mr. Watkins' references, and others, have been complimentary of his skills as a negotiator and in problem credit resolution in general. REW presently has eight individuals employed, all of whom are involved with the Jackson receivership, The receivership also employs approximately three hundred former FLB/FLBA staff persons.

Under the terms of the receivership agreement, the receiver is paid a flat salary and reimbursement for travel and subsistence costs. With respect to compensation, the FCA determined that in comparison with incentive-based compensation plans, a flat-rate salary agreement would very likely be a lesser cost method of compensation in the long term. Also, it was the FCA's determination that compensation based on incentives for rapid disposal of assets could conflict with the intent of the borrower rights provisions of the 1987 Act.

Question 6. Can you assure me that the farmers from my state will have a voice in the governance of whatever institution is established to serve their credit needs?

Answer 6. The law provides that the borrower/stockholders of a System institution are the only stockholders that are authorized to own voting stock of the institution. Thus, those stockholders have the right and responsibility to vote in the election of the directors of the institution. The FCA will be making every effort, within the law, to assure that a permanent solution to the Jackson territory is arrived at as quickly as possible.

Question 7. Why was the action to liquidate taken now, particularly since there was every indication that new management was aggressively developing a new assistance plan in the district?

Answer 7. In accordance with procedures established by the 1987 Act, the action to place the Federal Land Bank of Jackson in receivership was considered upon the request of the Assistance Board along with its notice that financial assistance had been denied. The FCA Board itself determined that the statutory basis for receivership existed under section 4.12 (b) of the Farm Credit Act and acted to appoint the receiver.

Question 8. How is the Federal Land Bank currently operating? I would like a complete account and explanation on the current status of operations at the bank, after the receiver was appointed.

Answer 8. The receiver is charged with the responsibility of closing out the business operations of these institutions, liquidating their property and assets, paying their creditors, and distributing the remaining proceeds to stockholders. Consistent with that objective, the receiver's staff has sent a letter to each Chief Executive Officer of the other district banks within the System dated June 16, 1988, to invite initial expressions of interest in the assets owned by the FLB and the FLBA. The receiver has since divided the portfolio into seventeen distinct parcels, received signed confidentiality agreements from 9 System-related parties, and distributed complete packages to those parties for bids on the entire portfolio, or its individual parts. Initial bids are due by August 5, 1988.

The "Federal Land Bank/Federal Land Bank Association of Jackson In Receivership" is organized as follows:

REW Enterprises, Inc.	- Receiver
Chief Executive Officer	- Project Manager
	- Public Relations
Director	- Legal
	- Insurance and Building Services
Director	- Internal Audit
	- Finance
	- Accounting
	- E. D. P. Operations
Director	- Human Resources
	- Assets
Director	- E. D. P. Loan Operations

Director - Special Assets, Real Estate, Prior Approval
- Collateral Custody
Director - Alabama State Coordinator
Director - Mississippi State Coordinator
Director - Louisiana State Coordinator

The Receivership has addressed or is addressing the following principal functions:

- Budget for the remainder of the calendar year.
- Staffing to package assets for sale and/or disposition.
- Procedures to facilitate the operations of the receivership.
- Ongoing appraisal of assets.
- Service to existing customers until loan assets are sold.
- Future staffing needs of the receivership.

Question 9. Who or what institutions can buy Federal Land Bank loans or assets? Can these loans be sold to non-system institutions? Is such a sale probable? I would also request any legal basis for the sale of system loans to non-system institutions?

Answer 9. In the normal course of business, a Federal Land Bank (called a Farm Credit Bank as of July 1988) is authorized to sell interests in loans to non-system institutions and to buy from and sell to System institutions interests in loans (Section 1.5 (16)). The receiver of a Federal land bank has the powers of the land bank and such other powers as are necessary to enable it to wind up the business operations of the institution, collect the debts owed to the institution, liquidate its assets, pay its creditors, and distribute any remaining proceeds to its stockholders. While a receiver can sell loans to non-system institutions, we do not have any basis at this point to determine whether or not such sale would be probable. The specific authorities of a receiver are set forth ~~in~~ 12 CFR Subparts K and M.

Question 10. From the regulator's view, how will assistance be given?

Question 11. I would appreciate a complete explanation of your understanding of the assistance provisions of the Farm Credit Act of 1987.

Answer 10 and 11. Since the FCA has no statutory authority to determine the manner in which assistance is provided to System institutions, we are not in the position to explain all of the alternatives of the assistance provisions in the 1987 Act. We respectfully defer to the Assistance Board to respond to this question.

Question 12. Please explain your consideration of having state-wide associations providing short-term and long-term credit services, as reorganization occurs. Please explain in detail the process to complete such a analysis, including advantages and disadvantages. Please give a priority listing of factors, you would consider in the process of reorganization of the district.

Answer 12. The Farm Credit Act of 1987 provides, for the first time, the authority for PCA and FLBA stockholders to vote to merge their associations,

thereby creating one entity providing both long- and short-term credit. The law also gives the Farm Credit Administration the responsibility to review the Plan of Merger and related disclosure documents and to approve those mergers that meet its merger requirements. Since mergers are voluntary actions undertaken by the associations whose stockholders vote to merge, the agency's role is to determine that the proposed entity has a realistic potential for viability, and to review the adequacy of disclosure to stockholders.

Regulations at 12 CFR 611.1122 and 611.1123 define the required documents to be submitted to the agency by associations wishing to merge. The agency has recently published in the Federal Register proposed amendments to those regulations which implement the 1987 Amendments. Existing regulations identify items that must be disclosed to stockholders for a merger to occur, including (but not limited to) a statement by the association's board giving the basis for its recommendation, the impact of the merger on stockholders and on the entities involved, the merger agreement, a summary of all bylaw and charter changes, proposed interest rate and fee programs, the capitalization plan, and both current and projected financial statements. The association boards must provide a joint letter to FCA stating the reasons for and the effects of the merger. The affiliated Farm Credit Bank must approve the merger before it is submitted to the FCA for approval by the Board. To facilitate the merger application process, the agency has recently provided all System entities a detailed checklist describing all regulatory requirements for merger submissions. In addition, the agency has requested that each district develop a districtwide plan that encompasses the needs or wishes of district associations to merge, disband and reorganize, or to seek reassignment to an adjoining territory.

The FCA will approve a merger request provided that all of the required documents have been submitted and are found to be acceptable. All disclosures must be adequate and must not misrepresent facts or tend to mislead stockholders. The merger proposal must not contain provisions which would be likely to lead to the operation of the resulting institution in an unsafe or unsound manner. Finally, the financial projection for the merged entity must be reasonable in its assumptions and must show that the institutions will be capable of maintaining its capital at a level required by the agency's capital adequacy regulations through generation of satisfactory earnings.

To make this determination, the FCA staff considers several factors. First and foremost would be the merger's effect on the financial strength of the combined entity and its ability to deliver quality financial services to its farmer-borrowers. Hence, the following priority listing of factors would guide the evaluation by FCA:

- Capital strength--The new entity must have (or be capable of achieving within an acceptable time period) an adequate capital base.

- Income generating capacity--The new entity should have capability to build capital through retained earnings.

- Potential loan volume--The market area of the new entity should

have the capacity of supporting an adequate level of long-term real estate lending as well as short and intermediate-term lending. This balance will allow the new entity to diversify its loan portfolio in terms of types of loans and terms and maturities of its loans--reducing the degree of risk in the portfolio.

Question 13. With regard to full, permanent banking services in the Jackson district, please:

A. Identify those permanent services which were not provided in the Jackson district and for what length of time;

B. Explain why those services were halted;

C. Identify any permanent services which have been restored in the Jackson district, when that occurred and of what the restoration of those services consisted;

D. Identify any permanent services which have not been restored to date, why restoration of permanent service has not occurred and when permanent service will be restored.

Question 15. With regard to restoring long-term lending on a permanent basis to the Jackson district, please:

A. List and explain all the different options which are available to be considered for restoring permanently long-term lending at Jackson;

B. Identify and list those options now under consideration;

C. Identify and explain who will make the decision to develop and implement a permanent long-term lending authority in the Jackson district and why;

D. Explain if the FCA and/or the receiver are now in contact with other system districts, such as Texas, Columbia, or Louisville, for one or several of them to serve as the permanent Federal land bank in the Jackson district; If so, please provide all documents relating to any such discussions.

Question 25. You stated that "one of the principal responsibilities faced by the receiver and the agency in the near term will be to take appropriate steps to arrange for permanent service to be restored to that district...." please explain:

A. "in the near term" and give an example of what you mean by this;

B. The permanent service to be restored;

C. What will happen in the interim until this permanent service is restored;

D. Why and how the receiver will be involved in restoring permanent service;

E. If permanent service will be restored prior to or after the July 6 mandatory FLB/FICB merger date and why.

Answer 13, 15 & 25. The Jackson District board announced on December 8, 1988, that the FLB would no longer be able to continue granting mortgage loans to farmers. The bank had lost virtually the entirety of its capital base thereby severely limiting its lending limit, and was unable to continue retiring borrower stock. Eligible borrowers in the Jackson district were unable to access FLB long term mortgage credit. Borrowers who had repaid their loans were not able to obtain retirement of their stock.

With the appointment of the receiver and subsequent agreement with the managements of the Columbia and Texas FLBs, interim mortgage lending services have now been restored and loan applications for new funds were accepted by both the Columbia and Texas FLBs as of June 21, 1988. Borrowers whose stock retirement had been discontinued received checks for their stock beginning on May 27, 1988. It is expected that other Farm Credit districts will make their interests in the territory and in the existing assets known in their responses to solicitations from the receiver. In this regard, the receiver on June 16 wrote the System institutions and invited their initial expressions of interest in buying these assets.

A number of options exist to formally reassign the Jackson FLB territory. The option finally chosen should be that which provides the greatest potential benefit to the borrowers in the Jackson district and which results in the least cost to taxpayers and the System. For example, it might involve a straightforward merger whereby an FCB incorporates all of the receivership assets, liabilities and territory into its existing operation and balance sheet; or a purchase of assets and assumption of liabilities, either selectively or in their entirety, by another institution from the receiver. If selective, some assets and liabilities would remain with the receiver for liquidation or, alternatively, be sold to still another party. Still another option, although not necessarily the most expedient one, would be to reassign the territory so as to accommodate new business, but leave the existing assets in the receivership until fully liquidated.

All options for restoring permanent land bank service in the Jackson District at the earliest feasible date are being carefully considered.

Question 14. Since the hearing on May 23, system institutions from Texas and Columbia have signed agreements to provide temporary long-term lending services in the Jackson district. Please explain:

A. The terms of those agreements;
B. The length of time they will last;
C. If both banks will serve borrowers who apply for long-term loans or if their services will be restricted on a regional basis; If there are regional service limitations, please identify of what they will consist and how they will operate;
D. The rights and protections that Jackson district borrowers have when they enter into a loan agreement with either the Texas or Columbia Land Banks;
E. What happens to these loans once a permanent land bank service is restored to the Jackson district;
F. If these borrowers will be eligible to vote as stockholders in those districts after entering into a loan agreement with them;
G. If these borrowers will be able to serve as directors on the boards of either of those banks or their associations if they have entered into a loan agreement with them;
H. If those banks will use local employees from the three-state Jackson district to serve borrowers or if they will bring in employees from outside the three-state Jackson district to serve Jackson district borrowers.

Answer 14. A. The major provisions of the agreements to provide long term real estate loans in the Jackson District on an interim basis provide that: 1) the Federal Land Bank of Columbia will accept loan applications from eligible borrowers in the states of Mississippi and Alabama, and that the Federal Land Bank of Texas will accept loan applications in the state of Louisiana; 2) if requested by the land bank, the Receiver will provide various support services on a reimbursable basis; 3) the permanent servicer for the Jackson District will purchase all loans made pursuant to the Agreements; 4) as defined in the Agreements, direct expenses incurred by the land banks in making any loans will be reimbursed to these land banks if they are not the permanent servicer by the Receiver to the extent funds for that purpose are made available by the Farm Credit System Assistance Board; and 5) the land banks are responsible for complying with all applicable laws and regulations in the making of any loans under the agreements.

B. The Agreements are in effect for successive thirty day periods from May 26, 1988, the effective date of the Agreements, unless terminated earlier by either party according to the terms of the Agreement. However, the termination date is December 31, 1988, unless extended by mutual agreement of the parties.

C. The Federal Land Bank of Columbia is accepting applications for loans in the states of Mississippi and Alabama and the Federal Land Bank of Texas is accepting applications for loans in the state of Louisiana.

D. The borrowers entering into loans made under the terms of these Agreements would have the same rights and protections as any other Federal land bank borrowers, except that the stock purchased as a condition of the loan will be non-voting until the loan is purchased by a permanent servicer for the District.

E. Once permanent land bank service is restored to the Jackson District, the permanent servicer will purchase and service the loans made under the Agreements.

F. Borrowers will be eligible to vote as stockholders once the loans are purchased by a permanent servicer.

G. The Agreements were executed pursuant to the out-of-territory loan authority contained in 12 CFR 614.4070(c). Therefore, since the borrowers would not be residents of the district of the respective land banks, they would not meet the eligibility requirements to serve as directors. However, it should be noted that these are interim agreements and that it is unlikely that a borrower would be significantly impacted by this restriction.

H. The Agreements provide that the land banks may utilize the existing personnel of the Receiver to accept loan applications. The land banks have the option of utilizing personnel in the Jackson District or their own personnel as needed in carrying out their responsibilities under the Agreements.

Question 15. Answered with question #13.

Question 16. Please explain how the Federal land bank being in receivership will affect (A) the joint management agreements in effect at the bank and association levels in Jackson and (B) the shared housing agreements in effect at Jackson.

Answer 16. The participation of the FLB and FLBA in joint management agreements with other System institutions in the district ceased when the receiver was appointed.

In a separate action the district board has appointed separate chief executive officers for the Federal Intermediate Credit Bank and the Bank for Cooperatives. The FLB in receivership remains part owner of office space it owned prior to appointment of the receiver and continues to pay its proportionate share of the office housing expenses.

Question 17. Please explain how the financial status of the FICB and the First South and Northwest Louisiana PCAs will be affected by the Jackson land bank being in receivership.

Answer 17. There is no effect on the balance sheets of the FICB and the PCA's from the receivership of the FLB/FLBA of Jackson.

Question 18. If safety, soundness, and prudence prompted the FCA to appoint a receiver on May 20, 1988, for the Jackson land bank, if the bank had been at zero net worth since December and was losing, on the average, an estimated $4.7 million per month since January 1988, if supervisory actions by FCA were not able to correct land bank problems in 1987, please explain why the FCA waited until May 20, 1988, to put the bank into receivership.

Question 28. FOR MR. DUNCAN:

Please explain how the 1987 supervisory arrangements to which you referred in your testimony were carried out and why the problems, as you state, "...did not get corrected in a satisfactory fashion and with the supervisory actions in place--indeed the problems continued..."

Question 29. FOR EACH OF THE FCA BOARD MEMBERS:

Regardless of what legislative actions the Congress was considering in 1987, those considerations in no way interfered with nor obviated the FCA's statutory responsibility to ensure that safe, sound and prudent practices were being implemented by the Jackson land bank. Please explain why the FCA did not take further appropriate regulatory action in 1987 within its existing powers at the Jackson land bank if, as Mr. Duncan stated, problems were occurring, supervisory actions were taken, but "...with the supervisory actions in place--indeed the problems continued...."

Answer 18, 28 and 29. The 1985 and 1986 amendments to the Farm Credit Act of 1971 provided the Farm Credit System and its individual institutions a broad range of self-help mechanisms in addition to those which already existed through interbank and interdistrict agreements. These mechanisms included loss sharing, deferral of expenses through use of regulatory accounting procedures (RAP) as well as the System's own voluntary interdistrict collateral sharing proposal.

The System requested Federal assistance in early 1987. It then possessed the resources ($1.6 billion in unallocated retained earnings and between $3 and 4 billion in excess collateral throughout the year) sufficient to manage its problems while that request was deliberated in the Congress. The FCA had been engaged from June through December in discussions with System bank presidents and district board chairmen to determine their intentions with respect to use of the self help mechanisms available. They chose not to do so, leaving the FCA to cause the Jackson FLB to utilize its resources to continue to provide credit services within the district. The FCA appropriately redefined its eligible collateral criteria and used its enforcement powers to cause the Jackson FLB to take corrective steps.

In response, the bank board and management increased attention to expenditures (losses had averaged $6.5 million per month previously), entered into an intradistrict collateral sharing arrangement and disposed of FLB mineral assets. These actions enabled the Jackson FLB to avoid a default on its obligations and to avoid the need for FCA to invoke statutory joint and several liability provisions, which would have had a potential impact on the securities market. Beyond this, however, and inspite of the FCA's supervisory actions, the FLB board and management were not successful in improving operation enough to achieve a marked reduction in the FLB's nonearning assets necessary to result in the needed earnings to return the institution to long-term viability.

By December 1987, H.R. 3030 and S. 1665 had been passed and were being considered in conference committee. The salient assistance provisions and the establishment of the Assistance Board, and its authorities in this respect, had been agreed upon and the intent of Congress substantially established. With expectations being that the President would sign the final legislation, it appeared that the prudent course of action was to delay taking further action with respect to the FLB until such time as the Assistance Board could, in accordance with the bill agreed to by both House and Senate, make an informed decision with respect to assistance. The FCA then increased its focus upon causing the Jackson board and management to further their efforts to achieve borrower service within Jackson through lending arrangements with FLB's in neighboring districts. This course of action enabled the Jackson FLB to take advantage of the provisions of the 1987 Act and to request assistance from the Assistance Board.

The full Board, however, had discussed the Jackson situation and fully reviewed and considered all options available. As early as November 3, 1987, the Board began to specifically consider the possibility of a receivership and unanimously authorized the FCA staff to prepare for the possible appointment of a receiver as well as other options for dealing with the financial problems of the Jackson FLB and FLBA. Senior FCA staff then began the process of selecting a receiver who would be ready if the Jackson FLB and FLBA were placed in receivership. Also in November 1987, FCA Chairman Naylor contacted the Chairman of FDIC and requested FDIC's assistance in the process of closing Jackson and appointing a receiver.

With the Assistance Board having reached its determination to deny assistance, there remained no means whatsoever for the Jackson FLB to survive. Accordingly, the FCA Board considered the condition of the Jackson FLB in relation to section 4.12 (b) of the Farm Credit Act and

appointed a receiver on May 20, 1988.

Question 19. Please explain if a newspaper article's reference to a FCA representative encouraging Jackson borrowers to seek alternative sources of credit is correct and accurate. If it is, please explain the authority for and the propriety and prudence of a regulatory agency's representative encouraging system borrowers to seek alternative credit sources, especially at a time when Jackson is trying to restore itself and the 1987 Act is being implemented to assist the System and its borrowers. (article copy attached)

Answer 19. The newspaper article's reference to an FCA representative encouraging Jackson borrowers to seek alternative sources of credit is not accurate. How remarks by FCA representatives might have been interpreted to arrive at the statement in the article is unknown to this agency.

Question 20. With regard to jurisdiction over the Jackson Federal Land Bank Receiver, please explain:

A. The jurisdiction and powers the FCA has over the receiver which are separate and different from those of the Assistance Board by virtue of the Board's assistance certification;

B. Any potential or actual problems in exercising jurisdiction over the receiver which may need to be clarified or corrected due to jurisdiction over him by the FCA and the Assistance Board.

Answer 20. In accordance with the 1971 Act and FCA Regulations, FCA has exclusive authority to appoint receivers of System institutions and establish the procedures under which such receiverships are operated. The Assistance Board's role with respect to the receiver include its responsibilities under section 4.9A(c) of the 1971 Act to request the Financial Assistance Corporation to provide the receiver with sufficient funds to enable the receiver to retire eligible borrower stock at par value and to carry out its other authorities with respect to providing assistance under the Act.

Question 21. Please identify the number of Jackson Land Bank and Land Bank Association employees who are affected by the receivership, how many are now employed by the receiver, how many were released from their jobs and what benefits are retained and lost by those employees whom the receiver has hired and those whom the receiver has released.

Answer 21. Prior to May 20, 1988, virtually all employees of the Farm Credit Banks of Jackson were joint Federal Land Bank (FLB)/Federal Intermediate Credit Bank (FICB)/Bank for Cooperatives (BC) employees. These employees were paid by the respective banks based on the proportion of their duties that were dedicated to each specific bank. Staff employed by the Farm Credit Services of Jackson were joint Federal Land Bank Association (FLB)/First South Production Credit Association (PCA) employees. These employees were paid by the respective associations based on a 50/50 split of salary and benefits costs. Except those employees of the Northwest Louisiana Production Credit Association, virtually all of the employees of the district were affected by the receivership, to the extent that they now are employed by a single entity rather than under joint

management.

The selection of employees to be retained by the respective banks, the receivership, or the PCA, ocurred in the following order:

		Employees
1.	First South PCA	226
2.	FICB of Jackson	65
3.	Jackson BC	34
4.	FLB/FLBA of Jackson in Receivership	300

On June 17 and June 22, 1988, the FICB, the BC, and the FLB/FLBA In Receivership jointly implemented reductions in force (RIFs) in the association and at the district level respectively affecting employees concentrated in the human resources and corporate development areas. These RIFs affected the district employees as follows:

- Association	19 (6 in Miss., 11 in La., 2 in Ala.)
- Banks	18
Total number of employees affected	37

Provisions have been made for calculation and payment of annual leave, severance pay in accordance with the district policy, and a limited extension of health and dental benefits. In addition, the following is being provided:

- Outplacement assistance classes are to be held in Jackson, June 22-24, 1988. These classes, conducted by counselors from the Farm Credit Corporation of America and another Farm Credit District Bank, cover the following topics: getting started, looking at options, applications and resumes, job search game plan, telephone skills, and interviewing. The Jackson Farm Credit Banks will provide typing and copying facilities for those affected.

- Counselor service will be available to those affected by the RIF.

- The Mississippi Rapid Response Team from Governor Mabus' office will also be available to provide job placement assistance, career counseling, financial guidance, unemployment benefits, and networking opportunities.

Question 22. With regard to the Jackson district banks, please explain:

A. If and when, over the past five years, the FCA examined the banks to determine if unsafe, unsound or imprudent business and management practices were being used;

B. The nature of the unsafe, unsound and imprudent business and management practices the FCA discovered as a result of any such examinations;

C. What steps the FCA took to correct them.

Answer 22. A. The Jackson Federal Land Bank was examined in February 1983, February 1984, October 1984, December 1985, June 1987 and March 1988.

B. & C. The unsafe and unsound practices cited in each examination and the actions taken by FCA include the following:

The February 1983 report cited declining credit quality. The February 1984 report cited the absence of goals and objectives addressing the deteriorating economic condition of the FLB. The October 1984 report cited inadequate recognition of losses, reporting of risk, managerial controls and credit administration. The December 1985 report cited inability of management to identify and react to deterioration in the FLB's loan portfolio, and inadequate credit administration, supervision of associations, and internal controls. In an effort to seek correction of the various unsafe and unsound practices disclosed in the examination reports, the reports were provided to and discussed with the Board of Directors of the FLB.

An examination of the FLB as of June 30, 1987 was commenced in January 1987 and continued through September 1987. Prior to issuing a formal report, FCA decided on May 19, 1987, that conditions were so serious that a temporary cease and desist order should be placed on the institution. A cease and desist order dated June 12, 1987, which was consented to by the FLB, required the FLB to cease and desist from the unsafe and unsound practices of operating with inadequate collection and servicing of loans, inadequate liquidity and capital, and operating in an undercollateralized position.

The examination report dated as of June 30, 1987 ultimately cited the inability of management to arrest erosion of capital, to take timely action to contain credit risks, to prevent losses in nonaccrual loans and acquired property, and to administer loan assets; inaccurate reporting; and operating with an inadequate allowance for loan losses. Furthermore, the report criticized the FLB for noncompliance with and inadequate response to the cease and desist order of June 12, 1987.

On November 6, 1987, a second temporary cease and desist order was placed on the FLB for operating with an inadequate allowance for loan losses. The FLB, after initially challenging the order, consented to its entry on January 20, 1988.

The March 1988 report cited the critical financial condition of the FLB, its impending illiquidity and collateral shortfall and its inadequate response to previous criticisms.

On May 17, 1988, the FCA determined that the unsafe and unsound practices of the FLB, among other things, were sufficient to satisfy the statutory criteria for appointment of a receiver.

Question 23. <u>FOR CHAIRMAN NAYLOR</u>:

Please explain what the phrase "loans in process" means in your statement "...the receiver is to observe the full force and effect of all

the borrower's rights that are in the 1987 Act, including loans in process."

Answer 23. The term "loans in process" refers to loans held by the Jackson FLB that were already in the process of foreclosure as of January 6, 1988, but on which a judgement had not been rendered. Although the servicing or debt restructuring of those loans would have been in accordance with the borrower rights provisions of the Farm Credit Amendments Act of 1985, the FCA has made the decision that the Receiver should accord those loans the new borrower rights provisions added to the 1971 Act by the Agricultural Credit Act of 1987, which was enacted on January 6, 1988.

Question 24. You stated, "and we will afford through our receiver full Borrower's Rights as provided under the law to all problem borrowers or loans that exist within that district." Please:

A. Explain how all the borrower's rights for Jackson district land bank borrowers, i.e., those whose loans are (1) accruing, (2) high-risk, (3) non-accruing, or (4) in foreclosure will be provided by the receiver as called for in the 1987 Act;

B. Explain how Jackson Land Bank borrowers will retain all borrower's rights on their loans if and when their loans are sold to either another Farm Credit System institution or to a non-FCS institution;

C. List all the "appropriate borrower's rights", as stated in your testimony, which would be attached to Jackson FLB loans sold by the receiver.

Question 25. Question and answer appear with questions #13 and #15.

Question 26. You listed four provisions in your testimony which supplement, you stated, the FCA's receivership manual and constitutes the entire agreement with the receiver. Please:

A. Explain if all System and non-system institutions which purchase loan assets from the Jackson FLB receiver also have to comply with currently and future proposed FCA regulations regarding (1) borrower rights; (2) sec. 4.14(A), regarding loans in process, foreclosure and on which a judgment hasn't been rendered; and (3) sec. 4.36, regarding property in inventory on January 6, 1988 and any property acquired thereafter;

B. Explain if the receiver, under the terms of his FCA agreement, has to comply with all currently and future proposed FCA regulations to implement the 1987 Agricultural Credit Act;

C. Identify the other applicable sections of the 1971 Farm Credit Act, as amended, including the 1987 act amendments, with which non-system institutions must comply if they purchase assets from the Jackson FLB receiver;

D. Identify and explain other provisions of the FCA's receivership manual with which the Jackson FLB receiver must comply and which constitute the FCA's agreement with the receiver;

E. Provide a copy of the FCA's receivership manual;

F. Explain if the four supplementary provisions listed in your testimony also will apply to any future receivership appointments within

the Farm Credit System which might be made by the FCA.

Answer 24. & 26. The Order Appointing Receiver specifically provides that borrower rights must be afforded to all borrowers in accordance with the Act and the proposed regulations. The agency's proposed regulation on borrower rights is attached for your convenience and reference. FCS institutions purchasing such loans would be required to apply the same regulatory standards as they do to loans which they make to borrowers in their territories. The FCA does not believe that the borrower rights provisions in FCS loan agreements, or those required by the 1987 Act, may be abrogated simply by selling a loan outside the Farm Credit System. Furthermore, FCA may condition sale of loans outside the System on compliance with the borrowers' rights provision or any other provisions of law the agency deems appropriate.

FCA receivership regulations recognize that additional duties may need to be imposed on receivers with respect to specific matters (See 12 CFR section 611.1161 (s)). Accordingly, as your question suggests, should the need for a receivership again arise, the agency would determine whether the circumstances of that case would warrant similar supplementary provisions. How categories of loans will be treated by the receiver will depend on the circumstances surrounding such loans and how the provisions of the 1987 Act and FCA regulations apply to each. FCA intends that borrower rights be fully accorded.

(** The committee has requested a copy of the receivership manual-Does the Board have any problem with providing the entire manual for the record.)

Question 27. You stated in your testimony "...the Federal land bank in receivership is not an eligible unit any longer." Please explain (1) that statement in light of FCA regulation 12CFR 611.1176, "final discharge and release of receiver," in particular its first sentence, (2) why the Jackson Land Bank in Receivership is not eligible to be merged under the 1987 Act's mandatory FLB/FICB merger provisions, and (3) how the mandatory FLB/FICB merger provisions of the 1987 Act will be implemented in the Jackson district with the Federal Land Bank in Receivership.

Answer 27. As you note, the charter of the FLB of Jackson In Receivership will not be cancelled until the liquidation is completed. However, since the receivership is established for the purpose of winding up the affairs of the institution in accordance with 12 CFR 611.1157, it is not empowered to perpetuate the operations of the institution through a merger with another institution. While no final determination has been made regarding a merger partner for the FICB of Jackson, every effort will be made to ensure that an appropriate resolution of this matter is implemented as soon as possible.

Questions 28 and 29 answered with #18.

FOR EACH OF THE FCA BOARD MEMBERS:

Question 29. Regardless of what legislative actions the Congress was

considering in 1987, those considerations in no way interfered with nor obviated the FCA's statutory responsibility to ensure that safe, sound and prudent practices were being implemented by the Jackson land bank. Please explain why the FCA did not take further appropriate regulatory action in 1987 within its existinng powers at the Jackson land bank if, as Mr. Duncan stated, problems were occuring, supervisory actions were taken, but "...with the supervisory actions in place--indeed the problems continued...."

Answer 29. Response of Jim R. Billington: I have never understood why the FCA Board and the Agency did not take action earlier in Jackson. Beginning in May, 1987, I began calling for certification under the 1986 Act in order to provide asssistance to troubled banks like Jackson. It had become obvious to me very shortly after my appointment to the FCA Board in October, 1986, that the Jackson FLB was in serious financial trouble.

I also pushed hard, starting in the Spring of 1987, with no success, for the FCA Board to place a conservator in Jackson to protect and quantify the remaining assets. Monthly losses were running as high as $6 million and the capital and collateral were going rapidly. Most of the important criteria for the appointment of a conservator existed, according to FCA's proposed Conservatorship Manual.

The agency did try through cease and desist actions to make necessary changes, but that action was too little, too late.

QUESTIONS FROM SENATOR TOM DASCHLE

For Frank Naylor:

If the Chairman would indulge me, I'd like to explore a little further FCA's thoughts on the Omaha Situation. What jeopardy has the Omaha District placed itself in by not applying for certification. Would this effect any adverse action they have taken?

What would the impact of this new status have on the other districts. It seems that this could undermine confidence in already potentially explosive situation?

Answer. We are advised by the Assistance Board that the Omaha Federal Intermediate Credit Bank and Federal Land Bank applied to the Assistance Board for certification on June 16.

To Frank Naylor, and Marvin Duncan:

Placing the Jackson Federal Land Bank into receivership has certainly opened a lot of eyes. As I am sure you can understand, I am concerned also about the Omaha Land Bank. I don't believe the situation is as bad in Omaha, but none the less, I am concerned.

As you know we have had a public exchange this past week in the Omaha District over certification for assistance. On the one hand, the Bank say it really doesn't need certification because they'll be above the 75%

stock level after the July 6 merger. Others say certification and oversight are long past due. And through it all, no one seem to "want the responsibility for determining that receivership should occur". It makes me wonder, whose watching the store? Given the situation in Omaha, I ask that the board refresh all of us on the sequence of events leading to certification of Jackson and what parallels can be made to Omaha. Specifically, what role did FCA play in certification of Jackson, how much coordination and communication actually took place?

Answer. May we refer you to the FCA's earlier responses to specific questions addressing the sequence of events leading to the FCA's appointment of a receiver for the FLB of Jackson. Please note that these events apply strictly to the specific developments and actions within and surrounding the Jackson FLB situation. Each such situation should and must be addressed independently and it would be inappropriate for the FCA to attempt to draw parallels between the Jackson and Omaha situations when no such parallels necessarily exist.

FARM CREDIT ADMINISTRATION
McLean, Virginia

ORDER APPOINTING RECEIVER
OF THE FEDERAL LAND BANK OF JACKSON, MISSISIPPI
AND
FEDERAL LAND BANK ASSOCIATION OF JACKSON, MISSISSIPPI

Pursuant to the provisions of § 4.12 (b) of the Farm Credit Act of 1971 (1971 Act), 12 U.S.C. § 2183 (b), and 12 C.F.R. § 611.1156, the Farm Credit Administration (FCA) Board, having determined that one or more of the conditions described therein exist, hereby appoints REW Enterprises, Inc., 1312 S. Troost, Tulsa, Oklahoma 74120, Receiver of the Federal Land Bank of Jackson, 1800 East County Line Road, Ridgeland, Mississippi 39157, and the Federal Land Bank Association of Jackson, 1800 East County Line Road, Ridgeland, Mississippi 39157, (together, Institutions). The Receiver shall shall take possession of all assets of the Institutions, wind up the their business operations, liquidate their property and assets, pay their creditors, and distribute the remaining proceeds to their stockholders, in accordance with the 1971 Act, FCA regulations, the FCA Receivership Manual, and this Order and any amendment hereto.

The following specific provisions shall apply to the conduct of the receivership:

(1) The Receiver is hereby authorized to request financial assistance from the Farm Credit System Assistance Board in connection with the operation of the receivership, including, but not limited to, debt transactions and funds for the retirement of borrower stock protected from impairment under § 4.9A of the 1971 Act.

(2) Loan assets of the Institutions shall first be offered for sale to other Farm Credit System (System) institutions prior to any offer to non-System institutions. Any sale of loan assets to a non-System institution must be conditioned on an agreement by the purchaser to comply with the borrower rights provisions of the 1971 Act, as amended.

(3) The Receiver shall comply with the 1971 Act and FCA proposed regulations on borrower rights published for comment on May 12, 1988 (53 FR 16937). The Receiver shall accord to borrowers the rights granted by § 4.14A of the 1971 Act with respect to all loans in process of foreclosure on January 6, 1988, on which a judgment had not been rendered. The Receiver shall accord to borrowers the rights granted by § 4.36 of the 1971 Act in connection with any property in inventory on January 6, 1988, and any property acquired thereafter.

(4) Ronald E. Watkins is authorized to sign any and all documents on behalf of the Receiver and may delegate his signatory authority, with appropriate administrative controls, to any employee of the Institutions-in-receivership as he deems appropriate.

IN WITNESS WHEREOF, the Chairman of the FCA Board has executed this Order and caused the seal of the FCA to be affixed hereto this 20th day of May, 1988.

FARM CREDIT ADMINISTRATION BOARD

BY: _____
Frank W. Naylor, Jr.
Chairman

PATRICK J. LEAHY, VERMONT, CHAIRMAN

JOHN MELCHER, MONTANA
DAVID H. PRYOR, ARKANSAS
DAVID L. BOREN, OKLAHOMA
HOWELL HEFLIN, ALABAMA
TOM HARKIN, IOWA
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JOHN B. BREAUX, LOUISIANA

RICHARD G. LUGAR, INDIANA
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JESSE HELMS, NORTH CAROLINA
THAD COCHRAN, MISSISSIPPI
RUDY BOSCHWITZ, MINNESOTA
MITCH McCONNELL, KENTUCKY
CHRISTOPHER S. "KIT" BOND, MISSOURI
PETE WILSON, CALIFORNIA
DAVID K. KARNES, NEBRASKA

United States Senate
COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

June 28, 1988

The Honorable Jim R. Billington
Member
Farm Credit Administration Board
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Mr. Billington:

We appreciate your testifying before the Committee on May 23, 1988. Enclosed are additional questions which are being submitted to you for written answers. We would appreciate receiving your answers to the questions by July 19, 1988 so that the hearing record may be printed as soon as possible.

Thank you for your cooperation.

Sincerely,

John Breaux

JOHN BREAUX
Member
Subcommittee on
Agricultural Credit

QUESTIONS FROM SENATOR TOM DASCHLE

Hearing on implementation of Ag Credit Act of 1987
in the Jackson District
May 23, 1988

JIM BILLINGTON, Farm Credit Administration

Placing the Jackson Federal Land Bank into recievorship has certainly opened a lot of eyes. As I am sure you can understand, I am concerned also about the Omaha Land Bank. I don't believe the situation is as bad in Omaha, but none the less, I am concerned.

As you know we have had a public exchange this past week in the Omaha District over certification for assistance. On the one hand, the Bank say it really doesn't need certification because they'' be above the 75% stock level after the July 6 merger. Others say certification and oversight are long past due. And though it all, no one seems to "want the responsibility for determining that receivorship should occurr". It makes me wonder, whose watiching the store? Given the situation in Omaha, I ask that the board refresh all of us on the sequence of events leading to certification of Jackson and what parallels can be made to Omaha. Specifically, what role did FCA play in certification of Jackson, how much cordination and communicaiton actually took place?

7

Hearing on implementation of Ag Credit Act of 1987
in the Jackson District

May 23, 1988

Questions from Senator Tom Daschle

In response to your question of who is watching the store, I believe that the F.C.A. through our examination and supervision functions is watching the store with sound goals and objectives. We now have two exams in many districts and associations. Our training is paying off in much higher quality examinations and the enforcement division is becoming effective in working with directors and management in troubled institutions to make the necessary changes needed to once again become safe and sound lending institutions.

Concerning the problem in Omaha, the Assistance Board and the Omaha Federal Land Bank are in contact and the question of certification is largely in their hands.

Mr. NAYLOR. On Friday, at 4:30 p.m., Central Daylight Time, the bank and its 90 service locations, the Federal Land Bank of Jackson, were closed simultaneously. And the receiver of the Farm Credit Administration, with technical support with the Federal Deposit Insurance Corporation, took over responsibility under the management of a receiver for the operations of the Jackson Federal Land Bank in receivership.

I would report to you that in the course of the weekend, the technical staff and staff of FCA and the receiver have completed their initial responsibilities.

And at 9 a.m. today, Central Daylight Time, all offices at the Federal land bank and its 90 service offices were reopened for business so that member borrowers could obtain information.

In addition to that, I am pleased to report that I have been notified within the last hour that the necessary arrangements which would permit our receiver to commence to retire eligible borrower stock under the act have been completed and that we will undertake at once to proceed with those actions.

It is my hope and belief that very shortly we will also be able to report to the committee that arrangements have been made for new loan service to be recommenced which has not been available to the district for some time through arrangements with other System institutions.

In addition, all of the borrowers in the district, some 21,000 most likely will have received or certainly by tomorrow will receive a letter detailing the information which they need to have with regard to the operations of the receiver and their particular loan.

It will advise them how to get information or other assistance concerning service in the district. It will also advise them of an 800 number and other supporting services that are available to help them in dealing with any service problems which they may have.

We intend to work very closely and diligently with the borrowers in the area and in our specific directions to the receiver, Senator, because that question has come up on several occasions, and among the specific orders is that the receiver is to observe the full force and effect of all the borrower's rights provisions that are in the 1987 act, including loans in process.

And we will afford through our receiver full borrower's rights as provided under the law to all problem borrowers or loans that exist within that district.

We intend to do the best in our power to minimize and in most cases have little or no disruption to the services being provided to borrowers within the district.

And, indeed, I think it would be fairly certain that some of the services which have not been available in part or in whole for some time will be very shortly restored.

The objective of the Farm Credit Administration is that its primary responsibility is the interests of the farmer, rancher, borrowers of the three-State area and to assure that Farm Credit System lending services for long-term lending are provided fully and completely by a viable operating institution.

One of the principal responsibilities faced by the receiver and the agency in the near term will be to take appropriate steps to arrange for permanent service to be restored to that district and to

assure that the act is fully complied with in the sense of providing full services to the entire country by Farm Credit System institutions.

I would like to add, Senator, for the record, my appreciation to the employees and others involved with the Jackson Federal Land Bank.

They were cooperative, supportive and, indeed, in most cases almost all of those employees are and have become employees of the receiver in an effort to maintain ongoing recognition and service.

We are working very closely with the Federal Intermediate Credit Bank and with the Bank for Cooperatives, both of whom have been in regular meetings with our representatives in Jackson and have made arrangements to provide ongoing responsibility for joint management and other related activities that have to be maintained in the area.

I think, thanks to the cooperation of the employees in the area, that the transition, serious though it was, has proceeded smoothly and to the benefit of farmer/ranchers in the area in that we have a common objective to restore viable, ongoing service of the level which they have a right to expect and which we intend is our responsibility to provide.

Thank you, Mr. Chairman.

Senator BREAUX. Thank you very much, Mr. Naylor and the other members, for being with us. Tell us, for the committee's benefit, about the terms and conditions of the contract that FCA has entered into with the receiver.

Is the receiver to carry out all the transactions? Is he to contract with others to help and assist in that endeavor?

And also you mentioned that borrowers' rights, as well as the repayment of the stock, would be taken care of through the receivership.

Tell us how the contract handles that to ensure that is to be done.

Mr. NAYLOR. Senator, I would be happy to provide for you a copy of the order appointing the receiver [1] and I would, if you would permit me to do so, simply read the four most specific items that go beyond the scope of our receivership manual which is a procedural and policy manual which has been approved and in place in the agency.

The specific provisions provide that, "The receiver is hereby authorized to request financial assistance from the Farm Credit System Assistance Board in connection with the operation of the receivership, including, but not limited to debt transactions and funds for the retirement of borrower stock protected from impairment under section 49(a) of the 1971 act.

"Two, loan assets of the institution shall first be offered for sale to other Farm Credit System institutions prior to any offer to non-System institutions. Any sale of loan assets to a non-System institution must be conditioned on an agreement by the purchaser to

[1] See page 59 for the order appointing the receiver.

comply fully with the borrower rights provisions of the 1971 act as amended.

"Third, the receiver shall comply with the 1971 act and FCA proposed regulations on borrower rights published for comment May 12, 1988. The receiver shall accord to borrowers the rights granted by 4.14A of the 1971 act with respect to all loans in process of foreclosure on January 6, 1988, and on which a judgment has not been rendered.

"The receiver shall accord to the borrowers the rights granted under section 4.36 of the 1971 act in connection with any property in inventory on January 6, 1988, and any property acquired thereafter."

And, finally, that our receiver authorize the appropriate signatory authority and other related authorities as our agent.

This supplements the agency's receivership manual, Senator, and constitutes the entire agreement with our receiver.

Senator BREAUX. It sounds as if what you're telling the committee is that for the purposes of the 1987 act, that the receiver is really being placed in the same shoes as if it were the Federal land bank having to comply with the terms with regard to the key features of the 1987 act.

Mr. NAYLOR. That's correct, Senator.

Senator BREAUX. That would extend even to the receiver, as I understood what you just said, selling off any of the loans to a nonfarm credit institution like a private company or insurance company.

Mr. NAYLOR. Our order would direct that any such sale would have attached to it the appropriate borrower rights that would go with those loans as though they were under the Farm Credit Act.

Senator BREAUX. Let me ask you about the requirement of the July 6 merger of the Federal Intermediate Credit Bank with the Federal land bank. How would that be handled with a Federal land bank that is in receivership?

Mr. NAYLOR. Of course, Senator, the Federal land bank in receivership is not an eligible unit any longer. That does not forgo the opportunity of the Federal Intermediate Credit Bank to engage in discussions as is going on all over the System to consider mergers with other Farm Credit System institutions, both for credit bank activities or to arrange some affiliation in the land bank area.

That will be in the hands of the Federal Intermediate Credit Bank and their Associations to determine what course of action they may seek to pursue.

Senator BREAUX. What happens on July 6? I could not hear it over the announcement. What happens when you have a requirement of a merger between the land bank—I mean, how is the mandatory merger affected by the receivership? Can you still proceed? Are the rights of the FICB affected any differently as a result of a land bank being in receivership?

Mr. NAYLOR. At this moment, in the sense of a Jackson District Federal Land Bank, there's not a bank to merge with. That does not preclude the Federal Intermediate Credit Bank however from pursuing merger opportunities with other System institutions and they are free to pursue that course if they elect to do so.

Senator BREAUX. Senator Boren.

Senator BOREN. Since there is no land bank at this point since it's in receivership, the Federal Intermediate Credit Bank of that district could merge with another district?

Mr. NAYLOR. It could merge with another district, Senator, if they wished to pursue that. That would not fall under the July 6 action, but under the broader merger provisions that are part of the 1987 act.

Senator BOREN. Between districts?

Mr. NAYLOR. Yes, sir.

Senator BOREN. When do you anticipate that there will be some decision made as to how service will be resumed on a long-term basis within the Jackson District and what district or districts might continue that service?

Mr. NAYLOR. Senator, the receiver and the agency will proceed as expeditiously as we can to enter into appropriate negotiations with other interested parties within the System who may be willing to take over or request an expansion of territory or for that matter, there are institutions even within the district which could make a proposal to affect service in the area also.

That will be a process in negotiation and looking for what will provide the best product and best services for farmers and ranchers in the area, the most sound and complete services, and we would hope that would be completed very expeditiously.

Senator BOREN. Senator Breaux and Senator Heflin, Senator Cochran and others have expressed concern to me about the fact that there has not been long-term lending available in Jackson since, I believe, December.

It's my understanding that FCA could immediately recharter the FICB as the Farm Credit Bank, thereby permitting the long-term lending to resume. And I wonder if you have contemplated such an action and might this not be the most efficient and perhaps most expedient, quickest way to make sure that we have long-term lending resumed, because that's a concern for all of us that those farmers be able to have long-term credit availability.

Mr. NAYLOR. Senator, I think the view of many has been that to provide the type of trained personnel appropriate to that service, the use of land bank institutions with that experience is, perhaps, at least in the near term, the most appropriate way to provide new loan servicing.

There have been discussions under way with other adjoining districts to provide that. It would be my expectation that our receiver and the agency are very close to having made such arrangements.

In fact, we would hope, within a matter of days, to have restoration of service on a temporary basis until a permanent solution is developed.

I would hate to prejudge or preordain who is best qualified to provide long-term service to the district or preclude ensuring that borrowers in the area are provided the best quality of service which may be available from the Farm Credit System as a whole.

Senator BOREN. But you think the most expeditious option is to try to find another land bank that would undertake the service of providing long-term credit as opposed to rechartering the FICB as a land bank?

Mr. NAYLOR. That is the procedure we're going on now and that would also leave open a more open path, I think, to negotiations for what the final service arrangement may be and allow the broadest flexibility to ensure that the borrowers in the area, farmer/ranchers in the area, have the best possible end product and service.

Senator BREAUX. Senator Heflin.

Senator HEFLIN. Mr. Naylor, and other members of the FCA Board, I understand that you looked at certifying the bank for assistance two times last year. Why did you not certify the Jackson bank's needs for assistance in 1985 or 1986? And why did you not ask for assistance through the Secretary of the Treasury?

Mr. NAYLOR. Senator, a wide range of reasons and if I may, because I don't have all the technical information, I would like to have—I would provide an expanded answer for the record for you.[1]

But there are a variety of problems as you are aware and we discussed which developed subsequent to the passage of the 1985 act.

Much of the function of the Capital Corporation was put into question by extensive litigation which developed throughout the System and raised questions about the legal authorities to carry out much of what was provided for, regrettably, in the 1985 act.

There was a fairly significant feeling, I think, even within the Jackson Federal Land Bank that they continue to pursue developing additional business plans in hopes that they would be able to deal with the problem themselves.

And we did very closely monitor the activity and I know that among some of the Members here in Congress during the process of the legislation—there was a concern that we work very carefully in any steps that we might take prior to the passage of legislation which would have changed, did change, substantially, the consideration of rights of a district for assistance.

Indeed, we did examine in late fall last year some action on the lines which you suggested. And just prior to that, which I think is a matter of public record, with regard to collateral and capital requirements, there was a concern raised and, indeed, one of the courts in Mississippi indicated that with the legislation imminent, there should be consideration, as I recall, of what might be available under new law.

It was the judgment of our counsel, late in the year, that to attempt to take an action in the face of imminent passage and signature of legislature providing a new form of assistance, that it would be inappropriate for us to move until the district had had an opportunity to apply and be considered for the alternatives provided under the new law.

And for those reasons, and I will add to those, Senator, in a broader answer, if I may, the agency elected for legal and other reasons not to take action prior to the passage and signature of the final act in 1987.

Senator HEFLIN. Mr. Billington, I have heard that you disagreed with the other two in the certification. If that is true, what was your position?

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[1] See Mr. Naylor's responses on pp. 41 to 58.

Mr. BILLINGTON. Senator, my position in May of 1987 was that we had a land bank that was in serious trouble in Jackson, Mississippi, and that it was not going to be able to bring itself out of its problems. At least that's the way the financial numbers appeared to me.

And it looked like the System as a whole was going to reach year-end with some material losses; $1.4 billion was quoted by many different people. This consequently changed to a slight profit, and probably rightly so, due to allowance for losses accounting changes in the System.

I thought at that time we should appoint a conservator in the Jackson Federal Land Bank in order to find out what we had down there. That's an appropriate way to discover needed information about an entity you really don't have full information about. We had done only one short exam at that time, so we really didn't have full information about the Jackson situation.

I felt like we should go in and do something. Because in some months last year there was over $6 million a month being lost and I felt like the bleeding should be halted as quickly as possible. A conservator could do that.

Whatever expertise that needed to be put into that bank needed to be placed there at that time as time is of the essence in a troubled financial institution.

It was a business decision, Senator, at that time. And I couldn't get the other two Board members to agree with me.

Senator HEFLIN. Earlier than that, was the disagreement between you and them that action be taken?

Mr. BILLINGTON. Not before May of 1987, I do not believe, sir.

Senator HEFLIN. Has there been other incidents since May of 1987, which was over a year ago, in which you have urged assistance be given to the Federal Land Bank of Jackson?

Mr. BILLINGTON. Yes, sir.

Senator HEFLIN. What was done?

Mr. BILLINGTON. Well, I thought in October we should do something and then our legal staff advised us that we probably didn't have justification for doing it, according to exam reports, but I still thought something should have been done.

Senator HEFLIN. Are there any other occasions?

Mr. BILLINGTON. Well, I was interested very early this year when the act was passed that something be done very quickly.

Senator HEFLIN. Mr. Naylor, I assume that before taking the action of placing the Jackson Bank in receivership that you would analyze very carefully and in much detail the benefits, costs and the risk in taking such action.

What is your staff's estimate of the total cost of liquidation the Jackson Federal Land Bank versus providing assistance to the Assistance Board?

Is your view that this was the least cost alternate for addressing the problems of the institution?

Mr. NAYLOR. Senator, under the provisions of the law, the Assistance Board is responsible for that assessment and has undertaken it and I suspect Mr. Thor would be better qualified to speak to their determinations than I.

They did make such a determination as required under the law and requested that the agency put a receiver in place.

We complied with our provisions of law and took the appropriate action to carry that out.

Senator HEFLIN. In regards to the land bank in Jackson as to what might be done, did you have consultations with OMB pertaining to proposed actions?

Mr. NAYLOR. I have had no discussions with OMB of any kind since I went to the agency, Senator.

Senator HEFLIN. Has anybody in your agency handled the consultation with them?

Mr. NAYLOR. No, not to my knowledge. We are not subject to the same type of oversight as the case of other regulatory agencies with OMB and I've had no discussions with OMB.

Senator HEFLIN. Obviously, we're concerned with a smooth transition, so that a disruption of service to the borrower is kept to a minimum.

What assurances can you give us that the approach taken minimizing the disruption of services to borrowers and particularly that the liquidation will not result in a fire sale approach and cause other borrowers to leave the System?

Mr. NAYLOR. Senator, I think quite the contrary. There has been a lack of service now for some time of the quality that I think farmers and ranchers have a right to expect in that area.

This is a first step of a long series of steps to be taken to restore the quality of service which they have a right to expect and we're in the process of doing that.

Within a matter of 48 hours since the receiver came into place, we have taken action to deal with the borrower stock issue.

We have had negotiations under way all through the weekend to restore new loan service. And we were able to reopen all offices without problem this morning to resume services.

Our instructions to our receiver are quite specific, that he fully and properly enforces borrower rights which has been raised as a question in the district in the past.

And we intend to proceed with great care in that matter as we properly should.

On balance, while there obviously will be some disruption in a change of this seriousness, the overall prospects, I think, are ultimately for viable and very strong service to the district on a permanent and ongoing basis into the future.

And I think this, on balance, has been far and away in the best interest of borrowers in the area.

Senator HEFLIN. The 1987 act puts into place certain significant protections for the Farm Credit System borrowers. If a loan is sold or is in receivership, is it still subject to the same borrower rights provisions as when it was held in the System institutions?

Mr. NAYLOR. That is the basis of our instruction to our receiver that it will be.

Senator HEFLIN. Now, you had mentioned in the paper that you would do that, but do you interpret the law to mean that that would follow?

Mr. NAYLOR. That's the basis of our instruction, yes, Senator.

Senator HEFLIN. It's not a discretionary approach?

Mr. NAYLOR. No.

Senator HEFLIN. Now, when a loan is sold, what happens to the B Stock held by the borrower? The 1987 act states that the borrower's investment in the System is protected.

How is this protected and who will be responsible for covering the cost associated with this protection?

Mr. NAYLOR. Ultimately, the Assistance Board is responsible for protecting borrower stock. And it is fully protected under the provisions of the 1987 act, regardless of the outcome of the ultimate actions by our receiver.

Senator HEFLIN. Would you please inform us of discussions that you had with neighboring Farm Credit System districts regarding loan activity and servicing loans.

Are you in contact with the Columbia, Texas, or Louisville districts and what has been the progress and provide us with any documents you might have. This might be furnished later or relative to the Jackson situation.

Mr. NAYLOR. Senator, there have been discussions under way as there was between the Farm Credit District or Federal Land Bank of Jackson prior to the time the receiver took over responsibility and if there are any records I would be happy to provide them.

We expect and are hopeful that that issue will be resolved momentarily and that we will be able to advise you very promptly that service has been restored

Senator HEFLIN. Can you give us any information about the appointed receiver, Mr. Watkins? Who is he and what qualifications does he have? How is he to be compensated and has he had any relationship with the Farm Credit System and how many people does he have working for him?[1]

Mr. NAYLOR. I would be pleased to supply many of those details for the record. I don't have all of them here with me. Except I would point out that Mr. Watkins has a long and distinguished career in dealing with troubled banks.

He is from Tulsa, Oklahoma. In the last 2 years he has provided consulting services for 12 troubled institutions in Oklahoma.

He comes highly recommended. He's very familiar with rural areas and farm and ranch problems and has a very sound track record of performance on which the decision was based.

Senator BOREN. Mr. Chairman, anyone from Oklahoma has a lot of experience with trouble in this area in recent years. [Laughter.]

Let me ask one question. I have received alarming reports over a period of weeks about extravagances that were conducted in the Jackson Bank, reports of such things as purchases of expensive antiques, Oriental rugs, the bank is generally referred to as "The Palace" I understand, during a period of time in which the farmers were struggling and going broke in record numbers and the System was in real trouble.

Is there any truth to these reports and does the FCA have the ability to get information about these kinds of business practices, or I would say nonbusiness like practices?

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[1] See page 43 for the supplied answer regarding Mr. Watkins.

And, if so, if it is found that a bank that is experiencing these kinds of difficulties is still engaging in very extravagant behavior, does the current law give the FCA the tools it needs to deal with a situation like that or does this subcommittee need to embark upon new legislative provisions to give either the FCA or some other appropriate agency the power to deal with a situation like that?

Mr. NAYLOR. Let me answer in reverse order. First of all, in the normal course of business actions, the purchase of furniture or cars or memberships or whatever is in the purview of the district board or the Assistance Board and their management.

If upon examination it was determined to have been excessive or imprudent, we have some limited authorities, but probably not of the degree that you may be inferring here.

With regard to the Jackson Bank specifically, I have no personal knowledge, although I have heard some of the same rumors you have and our receiver now has possession of all assets of the district.

And we will be pleased to provide you a report if, upon review of those, there's any evidence that there was any merit to those rumors which we have also heard.

Obviously, with a receiver in place, our ability to deal with it is much stronger.

Senator BOREN. Well, the receiver has taken possession of all assets then?

Mr. NAYLOR. Yes, Senator. As you well understand from your own experience, one of the reasons that one moves with some care is to ensure that all assets are properly accounted for and that they belong to the farmers and ranchers of that area, as the owners of that institution.

And to assure that they are secured and that the receiver has full control of them—that is the reason for a very closely held confidence of the matter and the timing to move in simultaneously as we did.

The reports I've received both from our people and the FDIC and our receiver was that that was executed without problem and the assets are under our control.

Senator BOREN. I think this subcommittee owes it to the farmers of that district to ascertain whether or not there were the kinds of extravagant practices about which there have been rumors and whether or not normal purchasing of furnishings and those sorts of things that would be necessary from a utilitarian point of view to conduct business for farmers who were going broke exceeded the normal costs of items like that, desks and rugs and pieces of furniture and lamps and so on.

The committee would be interested in knowing that and I don't want to state that—I've purely heard rumors to this effect. I have had no hard evidence presented to me.

But I do think we owe it to the farmers in that area to make an investigation into that matter and if the FCA could inform us now that these assets will be under the control of the receiver—as to the value of these furnishings in these executive areas of the bank—and the kinds of costs associated with them—well, I would appreciate it.

And then we can determine after that there may have been no impropriety. I hope there has not been.

But if there has been an impropriety that goes beyond the bounds of normal business practice, we then need to carefully consider whether or not the statutes give adequate authority or discretion to the FCA—I would imagine FCA would be the appropriate agency, perhaps some other—to deal with it if we have a situation where the local board does not deal with it.

Mr. NAYLOR. Mr. Chairman, we'll be very pleased to cooperate and provide you that information and discuss it with you with regard to whether anything further may be appropriate in the way of legislative action.

Senator BREAUX. Senator Karnes.

Senator KARNES. If I might just move to a different part of the country, just briefly, I would like to ask a question about my District, the Omaha District, if I could.

Several weeks ago, you may recall, we requested that the FCA do a special examination of the O'Neill and Valentine PCA's and provide a public report as far as the carrying out stock guarantee provisions of the act. Some of the borrowers are being treated unfairly and haven't been getting their stock repaid.

I know you've been up to your eyeballs in alligators in the last couple of weeks, but any idea, Mr. Naylor, as to when that report may be available?

Mr. NAYLOR. Our special staff that deals with that area will be commencing that work shortly.

We understand that there's some misunderstanding, perhaps, about who is eligible for return of stock in the case where a loan is in default or had other problems related to it and that is some of the related issues being raised here.

It is our responsibility, however, as the FCA to conduct a review of the receivership in those two institutions and satisfy ourselves and the Congress.

Senator KARNES. So, something in the near future can be expected. How long would an exam of that nature take?

Mr. NAYLOR. Well, it's going to depend on how extensive and how difficult it is to establish the claims of the individuals raising a question about whether they received appropriate payment and to review records, perhaps, in the Omaha bank as well as the association.

But we'll take anywhere from 30 to 60 days. I would judge that is typical, once you begin that type of review, depending on the complexity that develops after we're there.

Senator KARNES. The act that we're talking about, clearly provides that the borrower stock guarantee provision cover equities held by other financial institutions.

I have heard rumors to the effect that some of the FICB's are not providing payouts for those equities for other financial institutions in a timely fashion. Have you heard anything to that effect?

Mr. NAYLOR. I have not had any such instances brought to my attention. However, it is the subject of the normal examination process. And if such instances develop, appropriate action would be taken.

Senator KARNES. I have received a number of letters from commercial banks, bankers in our region about what they consider predatory pricing by various associations.

And the concern that they have is that some of this pricing by the Farm Credit System is below the cost of funds. Is that a concern of yours and have you heard anything from other districts about what they have characterized in the Omaha district as predatory pricing?

Mr. NAYLOR. The issue predominantly has occurred in your district, although they're isolated cases. They have been brought to our attention in other parts of the country.

I should emphasize that we're not concerned here with competitive pricing, but only with the possibility of a predatory pricing situation.

We have requested that banking institutions who have specific evidence which they believe indicates predatory pricing should bring it to our attention and we will examine it as appropriate to do so.

It is not going to be an easy issue to resolve in that the spread between commercial banks themselves within the given areas often is very substantial, as much as 3 to 350 basis points between neighboring banks on short-term lending.

So, what may be a significant underpricing in one bank situation may be competitive with the neighbor down the street.

We will look for those instances if they are legitimately brought to our attention, that are absolutely and correctly legally predatory pricing.

But the law clearly permits competitive pricing on the part of the Farm Credit System institutions and to the extent that that's the case, they are clearly authorized to do.

Senator KARNES. I would agree that competitive pricing is what we all would like to see. However, pricing below their cost of funds, whatever that might be, just adds to the burden that the Farm Credit Administration and the taxpayers have in the event that we have problems in the institutions.

That's all the questions that I have, Mr. Chairman.

Senator BREAUX. Senator Cochran.

Senator COCHRAN. Thank you, Mr. Chairman. Let me ask when the decision to appoint the receiver in Jackson was made.

Mr. NAYLOR. The initial request from the Assistance Board for us to proceed with the receiver was approximately 30 days old.

The reason for that delay is quite straightforward. The complexity of an institution of this size is enormous. The logistics to properly safeguard the assets of the farmer borrowers in the area is of primary importance in reestablishing service.

We had advised the Assistance Board, and they understood that, that we would need 30 days minimum from the time that we received such a request for us to be able to proceed and actually put it in place.

I think we need to remember, too, Senator that typically in a situation like this with the FDIC, the general knowledge that the institution is in serious difficulty is not that apparent as was the case in Jackson where there was a great deal of anticipatory concern as the general condition of the institution was widely known.

But we did move and met exactly the target that we had indicated. We had a rather substantial number of people who had to be removed from other jobs, including FDIC personnel who had to be moved out of Texas and other institutions in the Midwest to meet our requirements.

And that went smoothly, but it's a very complex undertaking.

Senator COCHRAN. Is this a situation where the group of you three gentlemen get together and actually vote on a decision?

Mr. NAYLOR. Yes, Senator. In every instance and every issue of this type involving regulatory action, the Board has voted. They voted unanimously on these actions.

This is all in the authorization to our receiver, and all the policy decisions related to this have all been acted on by this Board.

Senator COCHRAN. So, in this instance, each of the three of you, Mr. Duncan and Mr. Billington, as well as you, have voted to appoint the receiver. Is that correct?

Mr. NAYLOR. That's correct.

Senator COCHRAN. So, the differences that we were hearing a little while ago from Mr. Billington in response to questions from Senator Heflin were not related to the appointment of the receiver decision that has been made last Friday or just announced last Friday?

Mr. BILLINGTON. Well, if I might clear that up, Senator Cochran, the problem in liquidating a financial institution is do you do it as a going concern or do you liquidate it. And that's the big problem this receiver still is dealing with.

If you put a conservator in, you have the option of looking at it as a going concern and try to put people in place to keep it a going concern.

And once it reached the decline, financial decline it was experiencing in April, then about the only choice is receivership, because there are no assets left. No borrower capital is left.

Senator COCHRAN. Well, I suppose it gets down to a basic difference of opinion as to the outlook for the health of the agriculture sector economically and the possibility for the value of the assets to improve.

Is that the basis for the disagreement that you had? Were you more optimistic for the agriculture community being able to improve the value of its assets?

Mr. BILLINGTON. My concern is that you have a financial institution that's going to put a purchase—a P&A agreement in and you're going to sell those assets to somebody at probably some great discount.

Who is the receiver going to get to buy the Jackson assets? If you have to sell them, it's one thing. If you have a going concern you can do business with, it's another thing.

Last year, we had a going concern. Now, we do not have a going concern.

Senator COCHRAN. My understanding of the testimony of Mr. Naylor is that the Federal Intermediate Credit Bank is eligible to bid on the assets of the Jackson Federal Land Bank.

Mr. NAYLOR. Any group, including that one, could come forward with a proposal and if it's responsible it would be considered both within and outside the district.

And there is a wide range of options that are still available, even under the current circumstances. In some respects, it may even have been improved.

I can't speak entirely for my colleagues and perhaps Mr. Duncan may want to comment.

I would suggest that the record does not indicate, if you look at the voting record of this Board, the discrepancy that appears to be on the table here.

There has been a great deal of uniformity on the policy and other actions of the Board with regard to this institution. There have been a great number of extenuating circumstances which might have affected all of us in our views of what was realistic and what could be done and what was a practical solution of what might be accomplished at any point in time.

Senator COCHRAN. Mr. Duncan.

Mr. DUNCAN. It's always regrettable when an action such as this has to occur. However, from time to time, in the financial community, such actions do occur and in this case it was the considered and unanimous judgment of this Board that this action was the best way to stem the hemorrhaging on the rest of the Farm Credit System as a result of the losses in the Jackson Federal Land Bank and to return full Farm Credit System services to the farmers and ranchers of that Jackson District.

We had, over the course of 1987, engaged in a number of supervisory arrangements with the Jackson Federal Land Bank as is appropriate for independent financial regulators.

This Congress, I think, wisely, set the Farm Credit Administration out as an independent financial regulator and granted us intermediate supervisory authorities that we are able to exercise in an effort to promote correction of problems.

Those problems did not get corrected in a satisfactory fashion with the supervisory actions in place—indeed the problems continued, but upon advice of counsel, it was deemed appropriate and the Board believed also that it was appropriate with pending legislation to permit the Congress to move with its legislation, which could give the Federal Land Bank of Jackson another opportunity through the route of financial assistance from the Assistance Board.

Once the legislation was passed, signed and in place, the decision as to whether to provide financial assistance to return the Jackson Federal Land Bank to financial stability was a decision in the hands of the Assistance Board.

And the Farm Credit Administration, I believe, appropriately stood aside from further action on that Jackson Bank until we had received the decision of the Assistance Board.

Upon notification by the Assistance Board that they had chosen not to provide the necessary financial assistance to return the institution to financial stability, and they had requested a receivership, the FCA Board, after careful deliberations, acted to place the Jackson Federal Land Bank in receivership.

The receivership then in my judgment was the logical route to go. Receivership does permit the ongoing servicing of loans of that institution and provides the opportunity to bring other Federal land banks in to provide new lending service.

As you've heard, the offices of the bank and the association are open today for business. The paperwork has all been completed to permit the retirement of borrower stock where that is appropriate.

We have been working very diligently to put in place an agreement for the return of full financial services to the borrowers in that district. We hope that we are very close to having that in place.

The receiver indeed has a wide range of options for dealing with the financially troubled Jackson Federal Land Bank, including, for example, a purchase and assumption of the assets of that bank by another Farm Credit Bank.

It is my judgment that this was a prudent course of action. Deliberately, we did not move when it appeared that Congress was prepared to provide an additional avenue through which the Jackson Federal Land Bank could return to financial viability.

When it became apparent that the Assistance Board had chosen, based on their evaluation, not to make funds available, then the receivership was the logical course of action to take.

And the Board's action on that receivership at the Farm Credit Administration, I believe, Mr. Chairman, has been unanimous.

Mr. NAYLOR. In this receivership it has.

Senator COCHRAN. Is it my understanding then that the receiver rather than being instructed by you to proceed to liquidate the bank has the option to operate the bank. Is that correct?

Mr. NAYLOR. The receiver has responsibility to continue to provide operations while he winds down the activities of the Jackson Federal Land Bank.

And among those principal responsibilities which the receiver has is to work with the agency in providing permanent services by a Farm Credit System institution for long-term lending in the Jackson District area.

Senator COCHRAN. Well, now, that sounds encouraging. Is it the expectation of the regulators that there will be a continuation of long-term lending?

Mr. NAYLOR. Absolutely. That's required by law and it's our highest priority, to provide permanent long-term service from another Farm Credit System institution.

And that can be a variety of options which will be the subject of negotiation to ensure that your farmers and ranchers get the best possible deal in terms of quality and the extent of service.

Senator COCHRAN. Will the member borrowers in the Jackson District area be able to continue to participate in this new entity?

Mr. NAYLOR. They will be able to make full use of the facility once it is in place and the decision has been made on who the permanent supplier is. And that will be the result of negotiations between the receiver and other possible suppliers within the system for long-term service.

Senator COCHRAN. Thank you, Mr. Chairman.

Senator BREAUX. Senator Boren.

Senator BOREN. Just one last question. Is there any authority for the Assistance Board—I'm thinking now about maturing bank and note obligations which I know there are some in the Jackson Federal Land Bank.

Is the Assistance Board authorized to provide assistance to the Jackson Federal Land Bank in this situation for the purpose of meeting the maturing bond and note obligations?

Mr. NAYLOR. Yes. Under the provisions of the act, the Assistance Board can and we expect is right now working with the receiver to take the necessary steps to provide assistance as required.

Senator BOREN. What would happen if the Assistance Board decided not to certify Jackson for issuance of preferred stock for meeting these obligations? Would those obligations then fall back on the rest of the System in the other districts?

Mr. NAYLOR. It would fall back under the category of joint and several liability. However, I do not believe, and Mr. Thor can speak for himself—there's no expectation that that will occur.

Senator BOREN. So, the expectation now is that we would not be pushed into the liability situation with the other districts having to take up these costs, that the Farm Credit System Assistance Board will meet these costs at this time through the issuance of preferred stock?

Mr. NAYLOR. At this time, Mr. Chairman, we have no reason to believe that would occur.

Senator BOREN. I see Mr. Thor nodding his head in agreement. That's basically the case? You do anticipate the Assistance Board will act?

Mr. THOR. That's correct. Mr. Chairman, part of my testimony will be on that.

Senator BOREN. Thank you.

Senator BREAUX. Mr. Naylor, in response to Senator Cochran's question about long-term assistance, the situation at the Jackson Federal Land Bank is that they haven't made any long-term loans since last year, in December of 1987.

I am not that encouraged that the long-term loans in the future—I mean, what is so encouraging that we can say that long-term loans for the people in that district are any closer than they were the last time they were made in December of 1987?

Mr. NAYLOR. The necessary authority for us to enter—our receiver to enter into agreements with other district—provided that that service is provided—we have completed the necessary steps to do that.

There are a couple of technical points that are being resolved as we speak. We would hope that they will be completed within a matter of hours or a few days and that we will see service restored.

Senator BREAUX. That would be working with other districts to help make long-term loans in this particular district?

Mr. NAYLOR. The receiver is not authorized to make new loans. And, so, it's necessary for us to provide another source of new loans.

In this case we were working with other Federal land bank institutions to do so.

Senator BREAUX. As I understand your regulations, the Jackson Federal Land Bank is still a chartered institution and will remain so until its charter is canceled.

Back to the question of: What happens on July the 6th when you have a mandatory consolidation of the land bank and the FICB?

Mr. NAYLOR. I will have my legal staff be sure that we correctly put this in the record. But I do not believe that as a result of receivership such a merger would be a result of July 6, because the bank is in receivership.

But I will provide for the record a correct legal statement of the facts relating to that question.

[The information of legal counsel for the Farm Credit Administration Board follows:]

Upon request of the Farm Credit System Assistance Board and in accordance with the authority provided in section 4.12(b) of the Farm Credit Act, the Farm Credit Administration Board placed the Federal Land Bank of Jackson into receivership on May 20, 1988. Thereafter, the land bank's operations have been conducted in accordance with the FCA's receivership regulations, 12 C.F.R. 611.1155–611.1183, and other applicable law. As stated in 611.1155(b), a receiver is appointed essentially to wind up the business operations of the institution. The powers and duties of a receiver, contained in 611.1171 and 611.1161, are those necessary to effect this end. Accordingly, it is our view that a bank in receivership is not empowered to perpetuate its operations through a merger with another institution, an act which envisions an indefinitely continued existence of the institution. Thus, on July 6, 1988, the Federal Land Bank of Jackson in Receivership was not an eligible merger partner for the Federal Intermediate Credit Bank of Jackson.

Mr. BILLINGTON. I think it appropriate that we try to make sure that you understand that the receiver's role is to liquidate that bank down there, basically.

Senator BREAUX. But it's still a bank until that liquidation is completed and the charter is canceled.

Mr. NAYLOR. It's a bank in receivership. And I will be sure we accurately provide for the record a correct legal statement.

Senator BREAUX. Senator Heflin.

Senator HEFLIN. Was the decision made in 1987 that there be no new loans made, was that made by your Board or was that made by the bank?

Mr. NAYLOR. The correct answer is the bank ran out of capital and as such had no lending authority or ability to continue to make loans.

Senator HEFLIN. Since December, 6 months ago, they have been unable to take or make any new business whatsoever. In the meantime, in that 6-month period, did you all foresee that that could take place and try to restore the vitality of that institution?

Mr. NAYLOR. There were a number of options that the bank could have considered, including entering into agreements with adjoining districts and, indeed, they did undertake some negotiations which they were unsuccessful in completing.

The law also provided specific direction that had the right, indeed, were obligated to go to the Assistance Board for a determination of whether or not and in what form they might receive assistance.

The Assistance Board, I think, prudently and very carefully weighed that request. In fact, several business plans, it is my understanding, were offered to them.

And they ultimately decided that the receivership was the most appropriate course of action.

Senator HEFLIN. Was that the decision made by the bank rather than your Board?

Mr. NAYLOR. That is correct. The bank ran out of capital and, therefore, had no lending authority. Had they been able to raise capital in any way or enter into an agreement with another district to provide service through them, they could have restored and returned to making loans.

Senator HEFLIN. It was the Jackson Federal Land Bank decision rather than your decision or your joint decision?

Mr. NAYLOR. It was a matter of them not having the capital to be able to make loans and either not being able to raise additional capital or enter into an agreement or neighboring district to permit them to make new loans.

Senator HEFLIN. I believe you have a regulation do you not that tells them when they run out of capital that they are not to make——

Mr. NAYLOR. Not to retire stock.

Senator HEFLIN. But not to make—you don't have a regulation that tells them to cease——

Mr. NAYLOR. The capital is linked to the lending limit and when they are out of capital they have no funds, in effect, to make new loans.

If they have capital, they could have made loans or if they had arranged with the neighboring districts or other sources to make the loans, they had the authority to do so.

They could have offered new loans. They were unsuccessful in their efforts to do that.

Senator BREAUX. The subcommittee will take a short recess for a vote. Mr. Naylor, we would ask that you remain during Mr. Thor's testimony in case there are any questions.

[A brief recess was taken.]

Senator BREAUX. The subcommittee will come to order. We welcome at this time Mr. Eric Thor, president and chief executive officer of the Farm Credit System Assistance Board.

Mr. Thor, we are pleased to have you here. We look forward to receiving your testimony.

STATEMENT OF ERIC P. THOR, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FARM CREDIT SYSTEM ASSISTANCE BOARD

Mr. THOR. Thank you very much, Mr. Chairman. I appreciate the opportunity to testify before your committee today to discuss the recent actions by the Farm Credit System Assistance Board.

The Farm Credit Administration has given you a comprehensive overview of its actions since last Friday when it appointed a receiver for the Federal Land Bank of Jackson. This appointment was made pursuant to the request of the Assistance Board that the FCA consider such action. I am here today to discuss with you why we made that request.

Mr. Chairman, the Federal Land Bank of Jackson filed the fifth application for assistance we received and was financially the weakest of the five Farm Credit System institutions to apply to the Assistance Board since the Board was chartered on January 21—124 days ago. From the first, it was apparent that the stock of the Jackson Federal Land Bank was seriously impaired. The problem in the Jackson Federal Land Bank has been developing, as earlier

comments have pointed out, since 1983, when the bank had approximately $300 million in equity. As of last Friday, the bank's liabilities exceeded its earning assets by approximately $500 million. This means the board of directors and management of the bank have lost over $300 million in the past 3 years.

Since 1983, financial institutions of all types have been facing a number of challenges. Recent failures in savings and loan institutions, commercial banks and investment banking firms point out that we are dealing with common problems that are far reaching, beyond those unique to the Farm Credit System. Senate Banking Committee Chairman William Proxmire has pointed out in a recent study, done for him by the General Accounting Office, that many financial institutions in serious trouble today are the victims of management failure, as well as economic and financial factors. And, as we have seen with other financial institutions, recovery may not be possible in all situations.

I could cite many institutions in the private sector which have been recovering slowly; some have failed. In the past 3 years, over 190 agricultural banks have entered receivership as the best solution to their financial problems. In the State of Nebraska where I was born, and where my family still farms, 25 banks closed in the past 3 years.

As with other troubled financial institutions, some Farm Credit System institutions will recover; some may not. In the past week, the Assistance Board announced two decisions in response to requests by troubled System institutions—the Jackson Federal Land Bank and the Louisville Federal Land Bank. The Assistance Board actions in response to these requests show that the Agricultural Credit Act of 1987 has provided a workable and flexible mechanism for assisting, when appropriate, financially troubled institutions as well as methods for protecting the Nation's agricultural borrowers within the Farm Credit System. The Assistance Board is part of that mechanism, and after 4 months of intense effort by the Board, the Farm Credit Administration and others, I can report that the mechanism is working.

In all our dealings with troubled Farm Credit System institutions, the Assistance Board has maintained uniform priorities. These priorities have been affirmed by the farmers and ranchers we have met with throughout the country. First, we must assure that the farmers and ranchers in troubled Farm Credit districts will have available credit at competitive rates. Second, we must protect borrower stock as guaranteed in the act; and third, we must work out the best method of assistance to assure long-term viability for the System as a whole, realizing that perhaps not all individually troubled institutions can be saved.

Let me now outline the Jackson Federal Land Bank situation within that context. The Jackson Federal Land Bank's initial request for financial assistance was just that—a request for $410 to $610 million with very little accompanying information to justify the request or show plans for the future. After the Assistance Board's receipt of the Jackson Federal Land Bank's initial request, we visited the bank on February 11. At that time, we began to explore various options that the bank's officers and directors were considering to deal with the bank's problems on a long-term basis.

On February 23, we notified the bank's management and Board in writing of the information we needed with regard to their unsupported request for assistance, including a concrete business plan. We received an incomplete plan. The Assistance Board communicated with the bank on virtually a daily basis. However, we were unable to obtain a proposal that demonstrated potential for recovery without the prospect of massive, open-ended Federal assistance. In the opinion of the Assistance Board, no comprehensive, coherent financial and operating business plan was ever presented.

In April, a completely new and different proposal was submitted by the bank. The Board and its staff conducted a detailed and careful analysis of each new submission. Each proposal required us to examine complex legal and financial issues. One noteworthy point with regard to the last proposal from the bank and its management was that it recommended placing the Jackson Federal Land Bank in receivership.

Our long, detailed exploration of the bank's financial history, current financial and management problems, future financial needs, and the bank's credit management plans led the Assistance Board to conclude that it should request the Farm Credit Administration to initiate action to appoint a receiver for the Jackson Federal Land Bank. The Assistance Board was convinced that this was the statutory option it should take in light of all available information. The Farm Credit Administration agreed that this was a prudent action, taken in order to enable the Farm Credit System to continue to provide a full range of credit service to the borrowers in the three-State area.

The Assistance Board's intention in each troubled financial Farm Credit System district is to reestablish reliable, affordable agricultural credit to farmers and ranchers in the States served by the institution, and to protect the value of the borrower stock. Options available to the Board pursuant to the act include direct assistance and recommendations to the Farm Credit Administration or its Board with respect to merger, conservatorship or receivership. It is appropriate that the Assistance Board consider carefully the lowest cost solution, taking all relevant data into consideration. This is important, since public funds are involved. The U.S. Treasury and the taxpayer initially pay the interest on bonds sold to fund financial assistance. Ultimately, though, the System itself must fully repay this assistance, which means that farmers and ranchers will bear this burden through higher interest rates. The Board must strike a delicate balance in each case between too much and too little assistance.

Last week, the Assistance Board also approved an agreement with the Federal Land Bank in Louisville, which had requested our assistance soon after the Board was chartered. The Board, in conjunction with the Financial Assistance Corporation, will provide $90 million to assist the bank in returning to a healthy financial position. Louisville has a number of problems, including a high level of nonaccrual loans, flight of quality borrowers, and high debt costs. Today, Louisville has their third set of management since 1983.

Despite these problems, and in contrast to the request from Jackson, the Louisville bank's Board and management submitted a

well-thought-out, reasonable business and operating plan. The business plan submitted by Louisville in connection with its financial assistance request is a workable plan for financial recovery. Management is stronger. Its strategies for improving income and capital include addressing individual loan pricing; emphasis on loan restructuring; plans for reducing loan risks; reduction of operating expenses; implementation of a debt management plan, and a strong effort to preserve remaining capital.

In both actions, the Assistance Board achieved the goals envisioned by Congress when it created the Assistance Board. The Louisville bank presented the board with a workable plan for financial recovery. With Federal assistance, Louisville should recover and creditworthy farmers, ranchers, and borrowers will be assured of credit availability and services.

The Jackson Federal Land Bank, unlike that in Louisville, had a total debt of $1.9 billion, with accruing assets of only $1.4 billion. It had virtually no collateral or capital. The bank was insolvent. Since June 1986 the Farm Credit System and, later, the Assistance Board have provided nearly $140 million to this bank to prevent default on maturing debt obligations. To attempt to bring the bank to a viable financial position would require an unacceptable high cost.

The Jackson Federal Land Bank has acknowledged that a merger of the existing bank is unworkable. A merger would have helped the Jackson Federal Land Bank slightly but would have crippled the Jackson Federal Intermediate Credit Bank, which is at present only modestly in the black. Most importantly, a merger would have resulted in substantially increasing loan interest rates each year for the next 15 years for the farmers and ranchers who are borrowers in the Jackson District. Such an increase in interest rates to an already heavily burdened group of farmers simply was not acceptable to the Board. To divide the bank into a "good" bank and a "bad" bank, that is, merging the new "good" bank into the FICB and liquidating the "bad" bank, which was part of the April plan submitted by the bank, left unanswered the question of what to do with $1.9 billion worth of debt and $500 million in nonaccruing assets, except to make it the responsibility of the Federal Government.

Finally, as the bank, itself, suggested in a plan submitted to the Assistance Board in April, the Assistance Board concluded that receivership was the best solution to this troubled situation.

As you know, there are a number of concerns regarding this action and I want to address those and deal directly with several of them.

First, borrowers are concerned about credit availability and affordability, and about retirement of their eligible stock. We have been assured that their loans will continue to be serviced, and that for the first time in months new loans will be available, and that the interest rates should be more competitive.

During the 3 months the Assistance Board worked on the Jackson Federal Land Bank case, the most persistent complaint heard from Jackson borrowers was that the bank could not or would not retire eligible borrower stock.

The bank recently submitted a special request for financial assistance for the limited purpose of retiring eligible borrower stock. After a careful review of the amounts and recipients listed in the bank's request, the Assistance Board concluded that the information did not accurately cover those borrowers entitled to have their stock retired. I am happy to report that during the past weekend we reached an agreement with the receiver for the Jackson Federal Land Bank. He has been certified to issue preferred stock for sufficient funds to retire eligible borrower stock at par value as soon as possible. I have been assured that this action is now being completed, and that eligible borrowers should be receiving their checks within the next few days.

Second, I think there's a concern over the lessening of "local control" as a result of the receivership. For the past several months, the bank's borrowers, the farmers and ranchers in the area, have had virtually no control over their bank. The bank was not retiring borrowers' stock as loans were repaid, no new loans were being made, and we have heard repeatedly that the borrowers felt there was a lack of communication between them and bank management and directors. These problems should be eased most quickly and permanently by the appointment of a receiver. Shortly, instead of holding stock in an insolvent institution, with its bylaws under the control of Federal regulators, borrowers will be holding stock in a healthy institution that can respond to the needs of its owners without Federal interference.

Third, we are aware of the concerns regarding the triggering of joint and several liability. Even though the statutes provide for this possibility, the Assistance Board is working with the receiver to prevent a triggering from occurring in this case, and the assistance provided by the Board in February and April was specifically for this purpose. We believe that we have ample authority and resources at our disposal to avoid triggering of joint and several liability.

Fourth, regarding the continuation of credit service and resumption of lending in the Jackson District, both the Assistance Board staff and FCA officials have met with officials of various Farm Credit System institutions and others to discuss proposals for providing service to borrowers in the 5th District. These discussions are ongoing and the Assistance Board stands ready to assist in facilitating service arrangements.

Finally, we know that the investment community is watching this situation. Today the System has $54 billion in debt outstanding. The passage of the Agricultural Credit Act of 1987, combined with our efforts since then to implement the act as quickly and as efficiently as possible, has resulted in increased investor confidence which is reflected in the narrowing of spreads between System bonds and Treasury obligations of comparable maturities. The attached graph illustrates how the spread narrowed from a peak of 150 basis points last October. As of Friday, May 20, that spread is around 29 basis points.

Mr. Chairman, when I entered this room, spreads were down as low as 15 basis points, which is significantly below FNMA and FRDMAC; the first time that's happened in a very long time.

The System's total debt should benefit from these narrow spreads. That could save the System and the Government several hundred million dollars in the next few years.

Mr. Chairman, I will close by saying that I am proud of what we have accomplished since the Agricultural Credit Act of 1987 was enacted less than 5 months ago. Even before the Assistance Board was chartered, Secretaries Lyng and Baker moved quickly to establish the Board, hire staff, and respond to requests for assistance that they knew would be forthcoming. As required, the former Farm Credit System Capital Corporation was closed down. Within 15 days of the Board's charter, we retired more than $113 million in Capital Corporation stock in time for planting by farmers and ranchers around the country. In March we completed agreements that permitted the retirement of $20.5 million in frozen stock belonging to farmer and rancher borrowers in four Western States.

The Assistance Board also inherited from the Farm Credit System Capital Corporation 44 lawsuits filed by the Farm Credit System banks and associations against the former Capital Corporation and the Farm Credit Administration. The Board is actively pursuing all options in an effort to bring about dismissals of those suits and today only 29 remain outstanding.

The Assistance Board is working with other System institutions with diligence and prudence, carefully considering all options of extremely complex legal and financial problems. We intend to apply ourselves to each case, evaluating the best course of action to solve the problems facing each troubled institution, as we have done with the Jackson and Louisville Land Bank cases.

Thank you, Mr. Chairman. I will be happy to answer any of your questions.

[The prepared statement and attachments of Mr. Thor follow:]

Testimony
of

Eric P. Thor
President and Chief Executive Officer
Farm Credit System Assistance Board

before the
Senate Committee on
Agriculture, Nutrition and Forestry

May 23, 1988

Good afternoon, Mr. Chairman.

I appreciate the opportunity to testify before your committee today to discuss recent actions taken by the Farm Credit System Assistance Board.

The Farm Credit Administration has given you a comprehensive overview of its actions since last Friday when it appointed a receiver for the Federal Land Bank of Jackson. This appointment was made pursuant to the request of the Assistance Board that the FCA consider such action. I am here today to discuss with you why we made that request.

Mr. Chairman, the Federal Land Bank of Jackson filed the fifth application for assistance we received and was financially the weakest of the five Farm Credit System institutions to apply to

the Assistance Board since the Board was chartered on January 21st - 124 days ago. From the first it was apparent that the stock of the Jackson Federal Land Bank was very seriously impaired. The problem in the Jackson Federal Land Bank has been developing since 1983, when the Bank had approximately $300 million in equity. As of last Friday, the Bank's liabilities exceeded its earning assets by approximately $500 million. This means the Board of Directors and management of the Bank have lost over $300 million in the past three years.

Since 1983, financial institutions of all types have been facing a number of challenges. Recent failures in savings and loan institutions, commercial banks and investment banking firms point up that there are common problems that we are dealing with that are far-reaching - beyond those unique to the Farm Credit System. A recent study by the General Accounting Office, requested by the Senate Banking Committee Chairman William Proxmire, has pointed out that many financial institutions in serious trouble today are the victims of management failure, as well as economic and financial factors. And, as we have seen with other financial institutions, recovery may not be possible in all situations.

I could cite many institutions in the private sector which have been recovering slowly; some have failed. In the past three years over 190 agriculture banks have entered receivership as the best

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solution to their financial problems. In the State of Nebraska where I was born and where my family still farms, 25 banks closed in the past three years.

As with other troubled financial institutions, some Farm Credit System institutions will recover; some may not. In the past week, the Assistance Board announced two decisions in response to requests by troubled system institutions -- the Jackson Federal Land Bank and the Louisville Federal Land Bank. The Assistance Board actions in response to these requests show that the Agricultural Credit Act of 1987 has provided a workable and flexible mechanism for assisting, when appropriate, financially troubled institutions as well as methods of protecting the nation's agricultural borrowers within the Farm Credit System. The Assistance Board is part of that mechanism, and after four months of intense effort by the Board, the Farm Credit Administration and others, I can report that the mechanism is working.

In all our dealings with troubled Farm Credit System institutions, the Assistance Board has maintained similar priorities. These priorities have been affirmed by the farmers and ranchers we have met with throughout the country. First, we must assure that farmers and ranchers in troubled Farm Credit districts will have available credit at competitive rates. Second, we must protect

borrower stock as guaranteed in the Act; and third, we must work out the best method of assistance to assure long-term viability for the System as a whole, realizing that perhaps not all individually troubled institutions can be saved.

Let me now outline the Jackson Land Bank situation within that context. The Jackson Federal Land Bank's initial request for financial assistance was just that -- a request for $410 to $610 million with very little accompanying information to justify the request or show plans for the future. After the Assistance Board's receipt of the Jackson Federal Land Bank's initial request, we visited the Bank on February 11. At that time, we began the exploration of various options that the Bank's officers and directors were considering to deal with the Bank's problems on a long-term basis. On February 23rd, we notified the Bank's management and Board in writing of the information needed with regard to their unsupported request for assistance including a concrete business plan. We received an incomplete plan. The Assistance Board communicated with the Bank on virtually a daily basis. However, we were unable to obtain a proposal that demonstrated potential for recovery without the prospect of massive, if not open-ended, Federal assistance. In the opinion of the Assistance Board, no comprehensive, coherent financial and business plan was ever presented.

In April, a completely new and different proposal was submitted by the Bank. The Board and its staff conducted a detailed and careful analysis of each new submission. Each proposal required us to examine complex legal and financial issues. One noteworthy point with regard to the last proposal from the Bank and its management was that it recommended placing the Jackson Land Bank in receivership.

Our long, detailed exploration of the Bank's financial history, current financial and management problems, future financial needs, and the Bank's credit management plans led the Assistance Board to conclude that is should request the Farm Credit Administration to initiate action to appoint a receiver for the Jackson Federal Land Bank. The Assistance Board was convinced that this was the statutory option it should take in light of all available information. The Farm Credit Administration agreed that this was a prudent action, taken in order to enable the Farm Credit System to continue to provide a full range of credit service to the borrowers in the three-state area.

The Assistance Board's intention in each troubled FCS area is to reestablish reliable, affordable agricultural credit to farmers and ranchers in the district served by that institution, and to protect the value of borrower stock. Options available to the Board pursuant to the Act include direct assistance and

recommendations to the Farm Credit Administration or its Board with respect to merger, conservatorship or receivership. It is appropriate that the Assistance Board consider carefully the lowest cost solution, taking all relevant data into consideration. This is important, since public funds are involved. The U.S. Treasury initially pays the interest on the debt obligations issued to fund the financial assistance. Ultimately the system itself must fully repay this assistance, which means the farmers and ranchers will bear this burden through higher interest rates. The Board must strike a delicate balance in each case between too much and too little assistance.

Last week the Assistance Board also approved an agreement with the Federal Land Bank of Louisville, which had requested our assistance soon after the Board was chartered. The Board, in conjunction with the Financial Assistance Corporation, will provide $90 million to assist the Bank in returning to a healthy financial position. Louisville has had a number of problems including a high level of nonaccrual loans, flight of quality borrowers, and high debt costs. Today, Louisville has their third set of management since 1983.

Despite these problems, and in contrast to the request from Jackson, the Louisville Bank's Board and management submitted a well thought-out, reasonable business plan. The business plan

submitted by Louisville in connection with its financial assistance request is a workable plan for financial recovery. Management is strong. Its strategies for improving income and capital include addressing individual loan pricing; emphasis on loan restructuring; plans for reducing loan risk; reduction of operating expenses, implementation of a debt management program, and a strong effort to preserve remaining capital.

In both actions, the Assistance Board achieved the goals envisioned by Congress when it created the Assistance Board. The Louisville Bank presented the Board with a workable plan for financial recovery. With Federal assistance, Louisville should recover and creditworthy borrowers will be assured of credit availability and services.

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The Jackson Federal Land Bank had acknowledged that a merger of

the existing bank is unworkable. A merger would have helped the Jackson Land Bank slightly but would have crippled the Jackson Federal Intermediate Credit Bank, which is at present only modestly in the black. Most importantly, a merger would have resulted in substantially increasing loan interest rates each year for the next fifteen years for the farmers and ranchers who are borrowers in the Jackson District. Such an increase in interest rates to already heavily burdened farmers was simply is not acceptable. To divide the Bank into a "good" bank and a "bad" bank, -- merging the new "good" bank into the FICB and liquidating the "bad" bank -- which was part of the April plan submitted by the Bank, left unanswered the question of what to do with the $1.9 billion debt, except to make it the responsibility of the Federal government.

Finally, as the Bank itself suggested in a plan submitted to the Assistance Board in April, the Assistance Board concluded that receivership was the best solution to this situation.

We know that there are concerns regarding this action and I want to address several of them:

First, borrowers are concerned about credit availability and affordability, and about retirement of their eligible stock. We have been assured that their loans will continue to be serviced,

that for the first time in months new loans will be available, and that the interest rates should be more competitive.

During the three months the Assistance Board worked on the Jackson Land Bank case, the most persistent complaint heard from Jackson borrowers was that the Bank could not or would not retire eligible borrower stock.

The Bank recently submitted a special request for financial assistance for the limited purpose of retiring eligible borrower stock. After a careful review of the amounts and recipients listed in the Bank's request, the Assistance Board concluded the information did not accurately cover those borrowers entitled to have their stock retired. I am happy to report that during the past weekend we reached an agreement in which the receiver for the Jackson Land Bank will provide reliable data and the Assistance Board will certify the receiver so he can issue preferred stock for sufficient funds to retire eligible borrower stock at par value as soon as possible. I have been assured this action is now being completed, and that borrowers should begin receiving their checks within a few days.

Second, there is concern over a lessening of "local control" as a result of the receivership. For the past several months, the Bank's borrowers have had virtually no control over their Bank.

The Bank was not retiring borrowers' stock as loans were repaid, no new loans were being made, and we have heard repeatedly that borrowers felt there was a lack of communication between them and bank management. These problems should be eased most quickly and permanently by the appointment of a receiver. Shortly, instead of holding stock in an insolvent institution that by law is under the control of federal regulators, borrowers will be holding stock in a healthy institution that can respond to the needs of its owners without federal interference.

Third, we are aware of concerns regarding the triggering of joint and several liability. Even though the statutes provide for this eventuality, the Assistance Board is working with the receiver to prevent a triggering from occurring in this case, and the assistance provided by the Board in February and April was specifically for this purpose. We believe that we have ample authority and resources at our disposal to avoid triggering of joint and several liability.

Fourth, regarding the continuation of credit service and the resumption of lending in the Jackson District, both the Assistance Board staff and FCA officials have met with officials of various Farm Credit System institutions and others to discuss proposals for providing service to borrowers in the 5th District. These discussions are ongoing and the Assistance Board stands ready to

assist in facilitating service arrangements.

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Mr. Chairman, I will close by saying that I am proud of what we have accomplished since the Agricultural Credit Act of 1987 was enacted less than 5 months ago. Even before the Assistance Board was chartered, Secretaries Lyng and Baker moved quickly to establish the Board, hire staff, and respond to requests for assistance that they knew would be forthcoming. As required, the former Farm Credit System Capital Corporation was closed down. Within 15 days of the Board's charter, we retired more than $113 million in Capital Corporation stock. In March we completed agreements that permitted the retirement of $20.5 million in

frozen stock to farmer and rancher borrowers in four western states.

The Assistance Board inherited from the former Farm Credit System Capital Corporation 44 lawsuits filed by Farm Credit System banks and associations against the former Capital Corporation and the Farm Credit Administration. The Board is actively pursuing various options in an effort to bring about dismissals, and today only 29 remain outstanding.

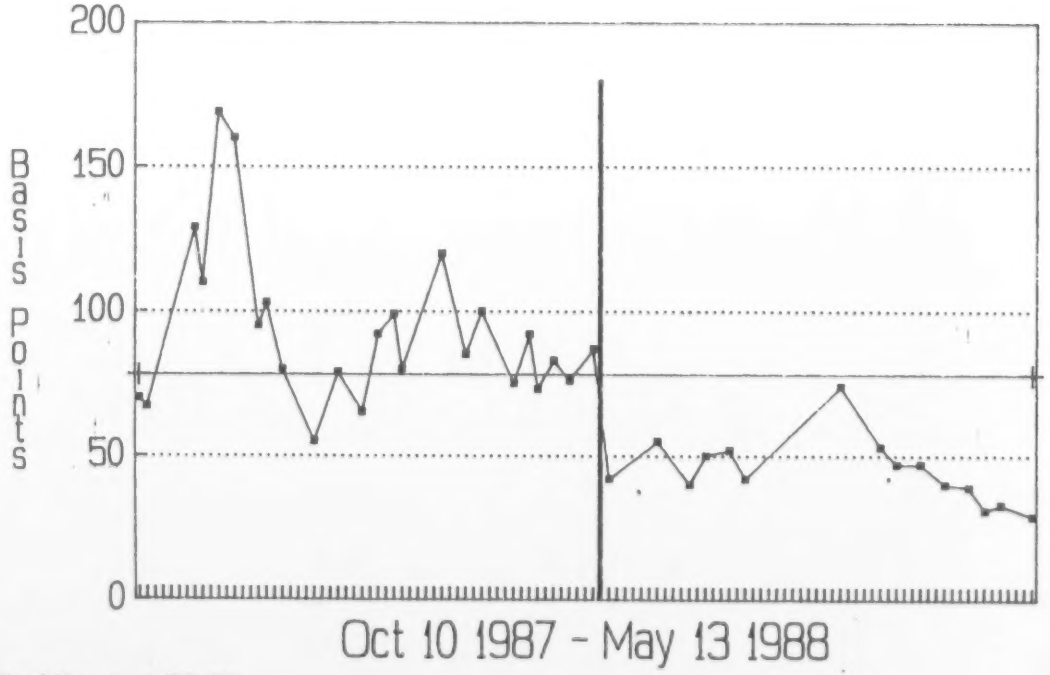
The Assistance Board is working with other System institutions and is doing so with diligence, prudence and by carefully considering all the options of an extremely complex legal and financial problem. We intend to apply ourselves to each case, carefully evaluating the best course of action to solve the problems facing each troubled institution, as we have done with the Jackson and Louisville Land Banks.

Thank you, Mr. Chairman. I will be happy to answer your questions.

Graph, letters, questions, and responses follow:

YIELD SPREAD: 6-MO FFCB & T-BILL

Closing Bid Yields



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day the Asst. Board was chartered

PATRICK J. LEAHY, VERMONT, CHAIRMAN

JOHN MELCHER, MONTANA
DAVID H. PRYOR, ARKANSAS
DAVID L. BOREN, OKLAHOMA
HOWELL HEFLIN, ALABAMA
TOM HARKIN, IOWA
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RICHARD G. LUGAR, INDIANA
ROBERT DOLE, KANSAS
JESSE HELMS, NORTH CAROLINA
THAD COCHRAN, MISSISSIPPI
RUDY BOSCHWITZ, MINNESOTA
MITCH McCONNELL, KENTUCKY
CHRISTOPHER S. "KIT" BOND, MISSOURI
PETE WILSON, CALIFORNIA
DAVID K. KARNES, NEBRASKA

United States Senate

COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

June 10, 1988

Mr. Eric Thor
President and Chief Executive Officer
Farm Credit System Assistance Board
Suite 702
1301 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear Mr. Thor:

We appreciate your testifying before the Committee on May 23, 1988. Enclosed are additional questions which are being submitted to you and to the Farm Credit Assistance Board for written answers. We would appreciate receiving your answers to the questions by July 1, 1988 so that the hearing record may be printed as soon as possible.

Thank you for your cooperation.

Sincerely,

JOHN BREAUX
Member
Subcommittee on
Agricultural Credit

THAD COCHRAN
Member
Subcommittee on
Agricultural Credit

HOWELL HEFLIN
Member
Committee on
Agriculture, Nutrition, and Forestry

Questions to the Assistance Board

1) In the last several months you have provided assistance in order to ensure that debt obligations are fully honored by Jackson. I believe this has been referred to as a "partial certification". I have not been able to locate, in the statute, where the authority lies for "partial certification". Why have you not provided full assistance. Please discuss where this authority is located in the '87 Act.

2) Mr. Thor, in the agreements between the Assistance Board and the Jackson Bank, of which 30 million dollars in assistance has been sent to Jackson, was there any mention of the retirement of the member borrower slock?

3) I understand that you are now going to finally retire the outstanding stock. How is today different for purposes of retiring stock from the day after enactment of the Agriculture Credit Act on January 7?

4) According to a May 20th report in the Clarion-Ledger/Jackson Daily News, FCA was informed a month ago that the decision was made by the Assistance Board to not provide additional support to the Jackson Bank. When was that decision made?

5) Obviously, we are concerned that there be a smooth transition so that disruption of service to the borrower is kept at a minimum. What assurances can you provide us that the approach taken minimizes the disruption of services to borrowers, and particularly that the liquidation will not result in a "fire sale" approach and cause other borrowers to leave the system?

6) The '87 Act put into place significant protections for Farm Credit borrowers. If a loan is sold or is in receivership, is it still subject to the same borrower rights provisions as if it were still held by a System institution?

7) When a loan is sold, what happens to the B stock held by the borrower? The '87 Act states that the borrower's investment in the System is protected. How will this be honored and who will be responsible for covering the costs associated with this protection?

8) Please inform the Committee of any discussions that you have had with neighboring Farm Credit Districts regarding the making and servicing of loans. Are you now in contact with the Columbia, Texas, or Louisville Districts? When will the Federal Land Bank be back in business in Alabama? Please provide this Committee with all documents relating to these discussions.

9. PLEASE DOCUMENT YOUR STATEMENT THAT THE JACKSON FLB AND ITS MANAGEMENT RECOMMENDED PLACING THE JACKSON FLB IN RECEIVERSHIP. PLEASE EXPLAIN IF (1) IT WAS PRESENTED AS ONE OF SEVERAL OPTIONS, (2) WHEN THIS RECOMMENDATION WAS FIRST PROPOSED TO THE ASSISTANCE BOARD, (3) WHO SUBMITTED IT, THE DISTRICT BOARD OR THE BANK'S MANAGEMENT OR BOTH, AND (4) THE PROPOSAL HAD UNANIMOUS SUPPORT OF THE BOARD AND MANAGEMENT.

10. WITH REGARD TO THE JACKSON DISTRICT'S REQUEST FOR ASSISTANCE TO RETIRE BORROWER STOCK, PLEASE EXPLAIN:

A. YOUR STATEMENT THAT THE BANK'S INFORMATION DID NOT ACCURATELY COVER THOSE BORROWERS ENTITLED TO HAVE THEIR STOCK RETIRED;
B. WHY YOU WERE UNABLE TO CERTIFY ELIGIBILITY FOR ASSISTANCE TO RETIRE STOCK FOR THE JACKSON LAND BANK BUT HAVE BEEN ABLE TO DO SO FOR THE BANK'S RECEIVER.

11. PLEASE EXPLAIN (1) WHAT JURISDICTION THE ASSISTANCE BOARD HAS OVER THE JACKSON LAND BANK'S RECEIVER NOW THAT HE HAS BEEN CERTIFIED TO RECEIVE ASSISTANCE, (2) WHAT TERMS AND CONDITIONS THE ASSISTANCE BOARD HAS IMPOSED OR WILL IMPOSE ON THE RECEIVER IN TERMS OF IMPLEMENTING THE PROVISIONS OF THE 1987 ACT, AND (3) HOW THESE ACTIONS WILL AFFECT THE BORROWERS.

12. WITH REGARD TO JURISDICTION OVER THE JACKSON LAND BANK RECEIVER, PLEASE EXPLAIN:

A. THE JURISDICTION AND POWERS THE ASSISTANCE BOARD HAS OVER THE RECEIVER BY VIRTUE OF THE BOARD'S ASSISTANCE CERTIFICATION WHICH ARE SEPARATE AND DIFFERENT FROM THOSE OF THE FARM CREDIT ADMINISTRATION;
B. ANY POTENTIAL OR ACTUAL PROBLEMS IN EXERCISING JURISDICTION OVER THE RECEIVER WHICH MAY NEED TO BE CLARIFIED OR CORRECTED DUE TO THE JURISDICTION OVER HIM BY THE FCA AND THE ASSISTANCE BOARD.

13. PLEASE EXPLAIN WHAT PROPOSALS BY OR REQUESTS TO THE ASSISTANCE BOARD ARE NOW UNDER CONSIDERATION OR WILL BE UNDER CONSIDERATION FOR ASSISTANCE CERTIFICATION TO HELP THE JACKSON LAND BANK RECEIVER MEET NEAR TERM AND LONGTERM BANK AND SYSTEMWIDE DEBT OBLIGATIONS.

14. YOU APPEARED TO DESCRIBE IN YOUR TESTIMONY THE JACKSON DISTRICT'S FICB SITUATION AS A "MINIMAL SITUATION IN THE BLACK." PLEASE EXPLAIN WHAT IS MEANT BY THE PHRASE "MINIMAL SITUATION IN THE BLACK," AND PLEASE PROVIDE DATA AS PART OF THE RESPONSE.

15. PLEASE EXPLAIN THE IMPACT THE APPOINTMENT OF A RECEIVER FOR THE JACKSON LAND BANK WILL HAVE ON THE FICB'S FINANCIAL SITUATION, ESPECIALLY IF IT IS A MINIMAL ONE IN THE BLACK.

16. PLEASE EXPLAIN FURTHER HOW JACKSON FLB BORROWERS WHOSE LOANS ARE (1) ACCRUING, (2) HIGH-RISK, (3) NON-ACCRUING AND (4) IN FORECLOSURE WILL BE BETTER OFF AS THE RESULT OF A RECEIVER BEING APPOINTED FOR THE BANK.

FARM CREDIT SYSTEM ASSISTANCE BOARD

Suite 702
1301 Pennsylvania Avenue, NW
Washington, DC 20004

(202) 737-9255

JUL 6 1988

Senator John Breaux
Senator Thad Cochran
Senator Howell Heflin
Committee on Agriculture,
Nutrition, and Forestry
Washington, D.C. 20510-6000

Dear Senators:

In response to your letter of June 10, 1988, we are enclosing answers to the questions you submitted relative to the Committee's hearing on May 23, 1988.

Should you have any additional questions, please don't hesitate to contact me.

Sincerely,

ERIC P. THOR
President and Chief
Executive Officer

Enclosure

QUESTIONS TO THE ASSISTANCE BOARD FROM
SENATE SUBCOMMITTEE ON AGRICULTURAL CREDIT

1. In the last several months you have provided assistance in order to ensure that debt obligations are fully honored by Jackson. I believe this has been referred to as a "partial certification". I have not been able to locate, in the statute, where the authority lies for "partial certification." Why have you not provided full assistance. Please discuss where this authority is located in the '87 Act.

Answer: The Assistance Board provided certification to the Federal Land Bank of Jackson in February and May, 1988, for the purpose of meeting debt obligations due the first week of March and the first week of May. The authority for this action was Section 6.5(a)(4) of the Farm Credit Act of 1971, as amended by the Agricultural Credit Act of 1987.

The Assistance Board took this action because the Board had not yet received sufficient financial and other information to determine whether to certify the Federal Land Bank of Jackson for the purpose of restoring economic viability. The Assistance Board concluded that the Bank would default on its debt obligations before it could provide the information and the Assistance Board could reach a decision. Accordingly, the Assistance Board decided that certification for the specific purpose of avoiding default on its maturing obligations was appropriate. The FCA Board would have been required to appoint a receiver if the Bank had defaulted on its obligations, thus preventing the Assistance Board from giving thorough consideration to the Bank's request for certification to restore the Bank to financial viability.

2. In the agreements between the Assistance Board and the Jackson Bank, of which 30 million dollars in assistance has been sent to Jackson, was there any mention of the retirement of the member borrower stock?

Answer: Assistance Board agreements with the Bank did not preclude the Bank from retiring borrower stock. Under the agreements, the Bank was required, among other things, to continue ongoing operations and not to dispose of assets other than in the ordinary course of business.

3. I understand that you are now going to finally retire the outstanding stock. How is today different for purposes of retiring stock from the day after enactment of the Agriculture Credit Act on January 7?

Answer: The Assistance Board does not retire stock of System institutions. Stock retirement requires action on the part of

the institution. The Assistance Board can and has made funds available when necessary to enable institutions to retire borrower stock in the ordinary course of business. The Assistance Board agreed to provide the receiver for the Jackson Bank with $5 million to retire eligible borrower stock in May, 1988. One of the receiver's first actions was to send 758 eligible borrowers checks for their stock.

When the Act was signed on January 6, the Assistance Board was not yet chartered and had not yet received the Jackson Bank application. The Assistance Board acted quickly to provided Jackson Bank with funds to avoid defaulting on its maturing debt obligations. The decision not to retire borrower stock following receipt of assistance was the Bank's.

4. According to a May 20 report in the Clarion-Ledger/Jackson Daily News, FCA was informed a month ago that the decision was made by the Assistance Board to not provide additional support to the Jackson Bank. When was that decision made?

Answer: The Assistance Board adopted the Resolution denying the Federal Land Bank of Jackson request for assistance and requesting the Farm Credit Administration Board to appoint a receiver for the Bank on April 18, 1988. The Assistance Board transmitted the request to appoint a receiver to the FCA Board Chairman a few days later. The FCA undertook preparations in conjunction with the Federal Deposit Insurance Corporation to take possession and control of the Jackson Bank. After those preparations had been completed, the Assistance Board formally notified the FCA Board that the Assistance Board would not provide the Bank with further assistance to restore the financial viability of the Bank. The FCA Board promptly appointed a receiver and took possession and control of the Jackson Bank. The coordinated effort was necessary to insure that both Federal bodies followed their statutory authorities and that possession and control of the Bank assets were properly taken and accounted for.

5. Obviously, we are concerned that there be a smooth transition so that disruption of service to the borrower is kept at a minimum. What assurances can you provide us that the approach taken minimizes the disruption of services to borrowers, and particularly that the liquidation will not result in a "fire sale" approach and cause other borrowers to leave the system?

Answer: The receiver is running a smooth operation, with little, if any disruption to borrowers. The Bank has remained open since it was placed in receivership on May 20. Borrowers are able to obtain long-term loans again, through arrangements with the Federal Land Banks of Columbia and Texas. The receiver has paid 758 borrowers for their eligible borrower stock. There is no indication available to us that borrowers are leaving the System

because of the receiver's management of loans and services.

6. The '87 Act put into place significant protections for Farm Credit borrowers. If a loan is sold or is in receivership, is it still subject to the same borrower rights provisions as if it were still held by a System institution?

Answer: Loans held by the receiver or sold to another System institution are subject to the borrower rights provisions under the Agricultural Credit Act of 1987. If a loan is sold to an institution outside the System, whether the borrower rights provisions remain in effect depends on the terms of the sale.

7. When a loan is sold, what happens to the B stock held by the borrower? The '87 Act states that the borrower's investment in the System is protected. How will this be honored and who will be responsible for covering the costs associated with this protection?

Answer: In the case where a System institution purchases loans from an institution in receivership FCA regulations provide that the borrower must immediately purchase stock in the purchasing institution. The receiver must retire the borrower stock when the loan is transferred. If the receiver does not have sufficient funds to enable the stock transfer, then the Assistance Board will make funds available to the receiver from the Farm Credit System Financial Assistance Corporation through the purchase of preferred stock. Thus, the borrower receives his stock back from the receiver but must purchase stock in the institution that purchases his loan. The borrowers then become stockholders in the purchasing institution. When the borrower fully repays his loan, the purchasing institution will retire his stock at par value in the ordinary course of business.

If the receiver does not have sufficient funds to retire the preferred stock held by the Financial Assistance Corporation, section 6.26(d)(3)(B)(iii) of the amended Farm Credit Act provides that the Financial Assistance Corporation shall withdraw funds from the Financial Assistance Corporation Trust Fund. To the extent that funds from the Trust Fund are insufficient, then the Farm Credit System Insurance Corporation shall use funds from the Insurance Fund to purchase the preferred stock. Should funds from the Insurance Fund be insufficient, then the Secretary of the Treasury shall purchase any remaining preferred stock. Then as funds become available in the Insurance Fund, the Insurance Corporation shall repurchase any preferred stock from the Secretary of the Treasury. Thus, ultimately all System institutions shall be responsible for the cost of retirement of borrower stock of the receiver through the payment of insurance premiums.

8. Please inform the Committee of any discussions that you have

had with neighboring Farm Credit Districts regarding the making and servicing of loans. Are you now in contact with the Columbia, Texas or Louisville Districts? When will the Federal Land Bank be back in business in Alabama? Please provide this Committee with all documents relating to these discussions.

Answer: Interim long-term loans are being provided to creditworthy borrowers in the Jackson district by the Texas and Columbia Federal Land Banks. Borrowers in Louisiana are being served by the Texas Bank and borrowers in Alabama and Mississippi are being served by the Columbia Bank. These loan servicing arrangements were worked out between the Texas and Columbia Banks and the receiver who would have copies of their agreements. The Assistance Board has no documents of these discussions.

9. Please document your statement that the Jackson FLB and its management recommended placing the Jackson FLB in receivership. Please explain if (1) it was presented as one of several options, (2) when this recommendation was first proposed to the Assistance Board, (3) who submitted it, the district board or the bank's management or both, and (4) the proposal had unanimous support of the board and management.

Answer: (1) The plan containing a suggested receivership for the Jackson FLB also called for the chartering of a new Federal Land Bank and a merger of the new bank and the Federal Intermediate Credit Bank of Jackson. (2) The plan was presented to the Assistance Board on April 11. (3) It was submitted by the chairman of the board of the Federal Land Bank of Jackson and, (4) had some support of the board of directors of the Federal Intermediate Credit Bank of Jackson, and the Federal Land Bank Association of Jackson.

10. With regard to the Jackson District's request for assistance to retire borrower stock, please explain:

(A) Your statement that the bank's information did not accurately cover those borrowers entitled to have their stock retired; and

(B) Why you were unable to certify eligibility for assistance to retire stock for the Jackson Land Bank but have been able to do so for the Bank's receiver.

Answer: (A) The Assistance Board requested information from the Jackson Bank of borrowers who had fully repaid their loans thus entitling them to have their stock retired at par value. The Assistance Board reviewed the Bank's information and discovered that many of the loans included were in the process of liquidation or foreclosure and were not fully paid. The Assistance Board decided to wait until the receiver for the Bank was in place, about 10 days later, to insure that those borrowers eligible to have their stock retired actually received their

funds. As previously mentioned, one of the receiver's first acts was to retire stock of some 758 borrowers.

(B) The Assistance Board certified the Jackson Bank in February 1988 to enable the Bank to meet its maturing obligations while the Assistance Board obtained additional information to consider fully the Bank's request to certify the Bank to restore it to financial viability. The Bank chose not to retire borrower stock though the Assistance Board made it clear to the Bank that the agreement did not prohibit them from retiring eligible borrower stock. Instead, the Bank chose to file an additional request for funds to retire borrower stock. The Assistance Board was preparing to provide the Bank with funds to retire such stock when it was discovered that the Bank information included an incorrect number of borrowers who had fully repaid their loans. As stated above, the Assistance Board determined it appropriate to wait until the receiver was appointed to insure that the correct borrowers received funds.

11. Please explain (1) what jurisdiction the Assistance Board has over the Jackson Land Bank's receiver now that he has been certified to receive assistance; (2) what terms and conditions the Assistance Board has imposed or will impose on the receiver in terms of implementing the provisions of the 1987 Act, and (3) how these actions will affect the borrowers.

Answer: (1) The receiver is under the same legal constraints as other System institutions which have been certified to receive assistance, as set forth in the Agricultural Credit Act of 1987. However, the receiver is closely regulated and monitored by the Farm Credit Administration pursuant to FCA regulations, FCA receivership manual, and FCA Board order appointing the receiver. Accordingly, the FCA has primary jurisdiction over the receiver for insuring that the receivership is properly conducted.
(2) Recognizing that the FCA has jurisdiction over the receiver, the Assistance Board does not anticipate the need for imposing terms and conditions over the receiver at this time. The FCA is committed to seeing that affordable agricultural credit is once again provided to creditworthy borrowers by System institutions in the area served by the Jackson Bank. Mechanisms are in place for future service. Eligible borrower stock is being retired. The receiver must also see that the receivership is conducted in a manner that minimizes the costs. The Assistance Board does not see the need for imposing additional terms and conditions at this time. (3) The activities in the Jackson District have had a favorable effect on borrowers by restoring available and affordable long-term credit and retiring eligible borrower stock.

12. With regard to jurisdiction over the Jackson Land Bank receiver, please explain:

(A) The jurisdiction and powers the Assistance Board has over the receiver by virtue of the Board's assistance certification which is separate and different from those of the Farm Credit Administration; and

(B) Any potential or actual problems in exercising jurisdiction over the receiver which may need to be clarified or corrected due to the jurisdiction over him by the FCA and the Assistance Board.

Answer: (A) The Assistance Board initially requests that the FCA appoint a receiver. The receiver once appointed is primarily under the jurisdiction of the FCA by statute, regulation and order. Although the Assistance Board does have some authority over the receiver pursuant to agreements to retire eligible borrower stock, the Assistance Board currently sees no need for increasing the governmental control over the receiver and looks to the FCA for properly monitoring, regulating and supervising the receiver. The Assistance Board coordinates with the FCA activities with the receiver to maximize efficient and effective administration of the receivership. This arrangement has operated smoothly thus far, and the Assistance Board expects the cooperation to continue.

(B) The FCA and the Assistance Board have separate and distinct responsibilities and jurisdictions where the receiver is concerned, as discussed above. No problems in exercising jurisdiction have developed. Cooperation here is important. There are still many important matters to be resolved to insure permanent long-term agricultural credit service available in the Jackson district, and cooperation is necessary for resolving them in the most effective manner.

13. Please explain what proposals by or requests to the Assistance Board are now under consideration or will be under consideration for assistance certification to help the Jackson Land Bank receiver meet near term and long term bank and systemwide debt obligations.

Answer: The Assistance Board will consider assistance to the receiver as it arises. The receiver has been able to meet its financial obligations to date. The receiver, FCA, the Assistance Board, the Funding Corporation and the FAC are working together to see that the receiver is able to meet its debt obligations and avoid a default on systemwide bonds.

14. You appeared to describe in your testimony the Jackson District's FICB situation as a "minimal situation in the black." Please explain what is meant by the phrase "minimal situation in the black" and please provide data as part of the response.

Answer: The Jackson FICB is financially solvent. The Assistance Board's financial analysis showed that the FICB was not strong

enough to withstand a merger with the Jackson FLB without financial assistance. Please see the attached most recent financial statements of the Jackson FICB.

15. Please explain the impact the appointment of a receiver for the Jackson Land Bank will have on the FICB's financial situation, especially if it is a minimal one in the black.

Answer: The receiver has been appointed only for the Federal Land Bank of Jackson, not the Jackson FICB. The appointment will have no direct effect on the FICB's financial situation. Placing the Jackson FLB in receivership positively affects the FICB in that it will not have to merge with the FLB as otherwise would have been required by section 410 of the 1987 Act.

16. Please explain further how Jackson FLB borrowers whose loans are (1) accruing, (2) high-risk, (3) non-accruing and (4) in foreclosure will be better off as the result of a receiver being appointed for the bank.

Answer: (1) Borrowers with loans in good standing will find it easier to obtain new loans and to receive servicing on their existing loans. Since December, 1987, Jackson District farmers and ranchers were unable to obtain new long-term loans through their land bank. They now are able to borrow through interim service with the Columbia and Texas Land Banks. Borrowers with paid off loans have already received checks from the receiver to redeem their borrower stock. Borrowers with high-risk and non-accruing loans and in foreclosure will be given full opportunity to explore having their loans restructured, as provided under the Agricultural Credit Act of 1987. Borrowers in the Jackson District will also be able to take advantage of the new demonstration project through their local Farmers Home Administration offices. This will permit acquired properties held by the Jackson Bank in receivership to be eligible for low interest farm loans from Farmers Home Administration.

Federal Intermediate Credit Bank of Jackson

Statement of Financial Condition
as of March 31, 1988
(thousands of dollars)

ASSETS	
Net Loans	$ 356,516
Investments	58,815
Equity in other Farm Credit Institutions	10,668
Net Acquired Property	4,859
Other Assets	34,519
Total Assets	465,377
LIABILITIES	
Notes payable	79,208
Farm Credit Bonds	283,235
Other Liabilities	5,813
Total Liabilities	368,256
NET WORTH	
Capital Stock	73,520
Earned Net Worth	23,601
Total Net Worth	$ 97,121

PATRICK J. LEAHY, VERMONT, CHAIRMAN

JOHN MELCHER, MONTANA
DAVID H. PRYOR, ARKANSAS
DAVID L. BOREN, OKLAHOMA
HOWELL HEFLIN, ALABAMA
TOM HARKIN, IOWA
KENT CONRAD, NORTH DAKOTA
WYCHE FOWLER, JR., GEORGIA
THOMAS A. DASCHLE, SOUTH DAKOTA
JOHN B. BREAUX, LOUISIANA

RICHARD G. LUGAR, INDIANA
ROBERT DOLE, KANSAS
JESSE HELMS, NORTH CAROLINA
THAD COCHRAN, MISSISSIPPI
RUDY BOSCHWITZ, MINNESOTA
MITCH McCONNELL, KENTUCKY
CHRISTOPHER S. "KIT" BOND, MISSOURI
PETE WILSON, CALIFORNIA
DAVID E. KARNES, NEBRASKA

United States Senate
COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

June 28, 1988

Mr. Eric Thor
President and Chief Executive Officer
Farm Credit System Assistance Board
Suite 702
1301 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear Mr. Thor:

We appreciate your testifying before the Committee on May 23, 1988. Enclosed are additional questions which are being submitted to you for written answers. We would appreciate receiving your answers to the questions by July 19, 1988 so that the hearing record may be printed as soon as possible.

Thank you for your cooperation.

Sincerely,

JOHN BREAUX
Member
Subcommittee on
Agricultural Credit

QUESTIONS FROM SENATOR TOM DASCHLE

Hearing on implementation of Ag Credit Act of 1987
in the Jackson District
May 23, 1988

FOR: ERIC THOR

In a letter the recievor has written to borrowers in the Jackson District, it says that "arrangements are being made with other Farm Credit System Districts to provide FLB and FLBA service for new loans to eligible borrowers in the Jackson District". What sort of action has actually transpired with the other Districts?

FARM CREDIT SYSTEM ASSISTANCE BOARD

Suite 702
1301 Pennsylvania Avenue, NW
Washington, DC 20004

(202) 737-9255

JUL 18 1988

Honorable John Breaux
United States Senate
Washington, D.C. 20510

Dear Senator Breaux:

Enclosed is the response to the additional question submitted in your letter of June 28, as part of my testimony at the hearing on May 23, 1988.

Please let me know if I can be of further assistance.

Sincerely,

/S/ ERIC P. THOR
ERIC P. THOR
President and Chief
Executive Officer

Enclosure

Question from Senator Tom Daschle

Q. In a letter the receiver has written to borrowers in the Jackson District, it says that "arrangements are being made with other Farm Credit System Districts to provide FLB and FLBA service for new loans to eligible borrowers in the Jackson District." What sort of action has actually transpired with the other Districts?

Answer: The receiver has reached agreements with the Columbia and Texas Farm Credit Districts to provide temporary long-term loan making services to eligible borrowers in the Jackson District. The Columbia District is serving borrowers in Alabama and Mississippi, while the Texas District is serving Louisiana. Negotiations are currently under way to provide permanent long-term credit services to Jackson borrowers, but no agreements have yet been reached.

Senator BREAUX. Thank you, Mr. Thor, for a complete and rather detailed statement. On page 2, of your prepared statement, just as general background with regard to the situation of the Jackson Federal Land Bank, you pointed out that the General Accounting Office, looking at failed financial institutions, discussed the various reasons why they have failed and pointed out that most of them are "victims of management failure, as well as economic and financial factors."

And looking at the situation in Jackson, what would your thoughts be as to the reason for the failure down there?

Mr. THOR. Mr. Chairman, there were a number of things that had gone wrong over the last few years in the Jackson situation. It really was a textbook case in what can go wrong in a financial institution. I would like to point out a few of those.

First of all, they had over $300 million in equity in 1983. And basically in addition to the $140 million, they lost over $300 million.

Today nearly 21 percent of the bank's loans are in nonaccrual status.

This has meant that they've had a level of poor loans over a period of over 2½—almost 3 years.

They have also seen their operating expenses, unlike some of the banks in the Farm Credit System and the commercial banking sector, actually increase significantly in 5 out of the last 6 years. Bank management has not taken the serious actions required to regain control of these expenses.

And as I said, even though there's a 50 percent decline in their base, their operating expenses increased nearly 2½ times.

Furthermore, they took on considerable debt. Today, the Jackson Federal Land Bank has the third highest debt cost in the Farm Credit System at 10.14 percent.

So, the Jackson Federal Land Bank had a number of problems that they had not been dealing with for quite some time.

Senator BREAUX. Did you do an analysis of their management and business practices prior to coming in with the recommendation for the receivership that would be available as part of the record?

Mr. THOR. Well, Mr. Chairman, we reviewed all available call reports of FCA. Those, as you know, are confidential.

I would be happy to discuss and submit for the record a statement on this if appropriate, but I believe I should work that out with counsel to make sure I'm not violating the act.

Senator BREAUX. Well, we certainly don't want you to run counter to that. I don't want to put words in your mouth again, but it seems that you've indicated an awful lot of what some people would term poor management practices down there.

Mr. THOR. I would say that's a fair assessment.

Senator BREAUX. Let me ask you about the situation with a receivership in place.

As I understand it, the FCA regulations ensure that the Jackson Federal Land Bank is still a chartered institution, even though it's in receivership, until the charter is removed.

Now, does your Assistance Board still retain all of its authority to provide assistance to a receiver, just as if it were a Federal land

bank and is there any problem with requiring that that receiver still follow the rules and regulations under the 1987 act?

Mr. THOR. Well, I think you're referring to the borrower stock issue and that is our understanding also. But we feel we have full authority in relation to the receivership to take a number of actions, including as we did over the weekend, certifying them to issue preferred stock.

And, so, the Assistance Board can take limited actions, some of which we've already exercised—and we've done so in a very meaningful and thoughtful fashion.

Senator BREAUX. What kind of an effect do you think the actions of putting the land bank into receivership would have on the FICB and the PCA's in the Jackson District?

Mr. THOR. As we look at the potential of merging the FICB and the PCA—I feel very strongly that they didn't want to merge. I'm not sure I would disagree with them.

The immediate result, because of the large size of the Jackson Federal Land Bank, obviously would have been a rapid depletion of what capital those two institutions have now.

We took a look at that option and felt that by 1989 they would be in a position similar to the bank's present situation.

The land bank is four times larger than the FICB and the FICB has had minimal earnings itself, only $24 million of retained earnings, of which $20 million has been allocated to the PCA.

So, you have a minimal situation in the black and to try to merge them with a very large, very troubled institution was a nonworkable option.

Senator BREAUX. Can you put a ballpark figure on the cost to the Treasury with regard to this receivership? We're talking about following through with retirement of stock that's eligible.

We're talking about new loans being put into place, at least a mechanism for providing for new loans, as well as servicing the existing loans.

Is there a ballpark figure that we're looking at as far as a cost?

Mr. THOR. We've taken a look at a number of options, but the exact amount will not be known until such a time as new long-term service is in. And we've been discussing that with staff for some time.

I would say our estimates for the receiver getting new service in there are in the $300 million range. It's our hope that we can be below that, substantially below that.

We looked at a number of options including assisting to viability and we feel that, especially with current management, it would probably run twice that.

In other words, it would have cost us over $600 million and as I said, it really would have been an open-ended situation, if we had attempted to go some other way.

Senator BREAUX. My final point. As head of the Assistance Board, can you assure the thousands of borrowers and farmers in those three States that these three Senators sitting at this table happen to represent—that they are going to be better off as a result of putting the bank into a receivership with regard to their interest in and their belonging to a land bank?

Mr. THOR. Mr. Chairman, I definitely believe so. We took steps over the weekend to ensure that borrower stock will be paid back and we will be working with the receiver and FCA to ensure this is the case.

Senator BREAUX. Senator Heflin.

Senator HEFLIN. From your testimony, is it fair to state that the decision of the Assistance Board not to allow assistance to go in effect, and recommended receivership because the Jackson Bank was just too far gone to try to revitalize it?

Mr. THOR. Again, Senator, we were looking at a number of options. I think we all had hoped we could find a way to do it. In the final analysis, as I stated, looking at all the available information, all the plans we had received from management it was our conclusion that their liabilities far exceeded their assets and it was going to be a terribly expensive process to go any other way.

Senator HEFLIN. I believe in answer to Senator Breaux's question, you had agreed there had been over a period of time poor management practice at the Jackson Bank. Would you say that they would go back as long as 3 years?

Mr. THOR. At least.

Senator HEFLIN. Four years?

Mr. THOR. Well, I don't know the exact time in terms of how far back it goes, but it's been a number of years from the reports we've seen.

Senator HEFLIN. Well, is the purpose of the regulatory agency to try to catch bad management practices and for the Government to correct those practices?

Mr. THOR. Well, again, as we look at the record, I believe a number of actions have been taken. We've been looking at this situation for some hundred-plus days.

There have been a number of actions taken by the regulators over time to try to deal with bad had management practices within the System.

So, this is not a new situation. It's not one that is unknown. I know there's been action on the part of the regulator and maybe you could ask them to review it for you to try to bring it into better balance.

Senator HEFLIN. Well, the regulating agency involved here is basically analogous to bank examiners on banks, is it not?

Mr. THOR. Yes, it is.

Senator HEFLIN. What lessons do we learn as a result of what has happened to the Jackson Land Bank?

Mr. THOR. I think we learned a couple of very important lessons.

As I stated in my testimony, there are several priorities that we really need to keep in mind in terms of making sure we have available credit at competitive rates in all parts of the Nation.

Furthermore, we have learned that there are a number of existing, unsound management practices that should be eliminated in the future and I outlined some of those for the Senator.

And as we proceed, I think we'll be trying to help those troubled institutions, as we did in the Louisville case, to develop a business and operating recovery plan that makes sense.

Senator HEFLIN. Do you see the need for any additional or changed legislation to deal with these problems like that that have arisen in the Jackson Land Bank?

Mr. THOR. At this time, no.

Senator HEFLIN. Do you anticipate that the present borrowers will be inflicted with a higher rate of interest on loans, on their loans, as a result of what has happened at the Jackson Land Bank?

Mr. THOR. I think, in fact, quite the opposite should happen. They will end up having more competitive rates than they have now.

Our analysis shows that if the district had taken on additional debt, the loan rates could have gone up over 50 basis points, to try to pay back the debt.

So, I think quite the contrary, they're better off in this situation than they would be with any other form of assistance we could give.

Senator HEFLIN. How about under the variable rate? Do you anticipate that as a result of this that the borrowers at the Jackson Federal Land Bank are going to have to pay a higher rate of interest as a result of this under the variable rate structures?

Mr. THOR. I don't think so. Again, I would like to get back to you with an analysis, rather than answer this off the cuff. But we don't see any particular problem.

Senator HEFLIN. What about new borrowers who come in under this—under whatever structure is there, the Jackson Federal Land Bank—will they be paying on new loans higher rates of interest than other land banks and as other institutions might charge?

Mr. THOR. Looking at the posted rates that have been in the Jackson District, they have been as high as 12.5 percent. In other districts, such as Columbia and Texas they're lower. In fact, they're below 10 percent in some areas.

So, again, I see nothing that would suggest that they're going to have higher rates as a result of any of these actions, but, in fact, quite the contrary.

Senator HEFLIN. How long has that differential been in existence between other land banks and the Jackson Federal Land Bank?

Mr. THOR. I'm not sure.

Senator HEFLIN. Two years, three years?

Mr. THOR. Each of the land banks sets the rates based upon the cost of funds.

The Jackson District had the third highest and as a result, would always have rates higher than most other System institutions.

Senator HEFLIN. Well, isn't the fact that they would be charging a higher interest rate a warning signal relative to its viability?

Mr. THOR. If they were setting rates at the margin, I would agree with you. But without knowledge of the history I'm not able to answer that.

Senator HEFLIN. We, of course, now passed various amendments and we've gone through various stages in regards to trying to rescue the Farm Credit System.

We had one bill that was vetoed by the President, which would have helped, in my judgment, a considerable amount relative to the credit problems of the farmers of the United States.

Now we've had other amendments, 1985, 1986 and 1987.

Now, if there is, from your viewpoint and from the Farm Credit Administration viewpoint any additional legislation that they think they need to stabilize the Farm Credit System, I would like for them to come forward and let us know this.

We don't want to see a repetition of this in the other Farm Credit Systems throughout the United States. And we already—well, we have been hearing now for many months that Spokane and Omaha were in similar condition to Jackson.

So, if there is a need for any additional legislation, I think that it should be forthcoming. That's all.

Senator BREAUX. Senator Cochran.

Senator COCHRAN. Thank you, Mr. Chairman. When the other witnesses were before the committee, I asked a question about how the member borrowers would participate in the decisions or management of any new entity. And I didn't understand the answer that I got.

Do I understand that the member borrowers will continue to have a right to participate in any new entity that may acquire the assets of the Jackson Federal Land Bank? How will that work?

Mr. THOR. Well, Senator, there are a number of provisions in there, depending upon what does happen according to the FCA regulations. And I guess I would prefer for them to comment.

But let me point out regarding local control, I think they'll have much more local control under this plan than any other, because they will, in our opinion, end up with a healthy financial institution. They will end up with their stock being paid back promptly. And they will end up able to work through their local offices, even though they may be in a restructured system at some point, to regain what they haven't had for a long time, which is competitive agricultural credit in their area.

So, it really depends upon what the various parties in the Jackson district decide, including the PCA and the FICB. Remember, those boards of directors, those management teams, are not part of this decision and they can set their own course.

So, I see much more local control than existed last Thursday, for example.

Senator COCHRAN. Well, in response to Senator Heflin's question about the impact on interest rates, it would seem to me, too, then that the new entity would be in better position to charge more competitive interest rates than was true under the old system before the receiver was appointed. Is that your understanding?

Mr. THOR. That's our perception too.

Senator COCHRAN. So, that, as far as the borrowers are concerned, is it fair to say that their interests are going to be benefited by this new restructuring? Is that what your assessment is?

Mr. THOR. That's our hope. We're all trying to work very diligently as has been mentioned by FCA, to get available credit in the district as soon as possible.

As Mr. Naylor has pointed out, we're very close to an agreement that would allow that to happen, hopefully this week.

And if that's the case, we'll be back up here to tell you about that and go forth from there.

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Senator COCHRAN. Let me ask you about the loans that are now served, as I understand it. Is there a joint management team in place involving the land bank and the FICB management?

Mr. THOR. That's correct. They've had a joint management team for some period of time.

Senator COCHRAN. Well, does that continue in effect?

Mr. THOR. No.

Senator COCHRAN. The receiver takes the place of that doesn't he?

Mr. THOR. The receiver takes over on the land bank side. What the receiver does is under FCA's control and regulation. So, I would like them to comment on that.

Our understanding is that the FICB is still an independent financial entity that is operating independently of the receiver, even though there are joint employees, which means, for example, that the FICB keeps a separate set of books and records.

So, again, I would prefer for FCA to comment directly on that.

Senator COCHRAN. Mr. Chairman, could we ask Mr. Naylor or someone to respond to that?

Senator BREAUX. Yes. Mr. Naylor.

Mr. NAYLOR. In answer to your question, there are identifiable sets of land bank employees in the Jackson District, as well as employees who are under joint management.

In other words, their salaries—they work for both the Federal Intermediate Credit Bank and for the land bank.

Over the weekend our staff, working with staff in Jackson, has identified those employees that belong strictly to the land bank and those that will be working for the receiver and receiver employees.

They also identified the joint employees continuing an arrangement where we would share the expenses with the Federal Intermediate Credit Bank until final resolution of the land bank situation is made.

Senator COCHRAN. Does this mean that the FICB is going to participate as part of the management team with the receiver during this receivership?

Mr. NAYLOR. No. What we are really saying here is that there are some joint employees, particularly in the Association, that provide support to both the Land Bank Association and the Federal Intermediate Credit Bank.

The agreement has been completed on what services will be continued and what expenses will be shared.

Senator COCHRAN. Who is going to provide service to the borrowers?

Mr. NAYLOR. Association employees, all 90 of those Land Bank Association offices and most of the joint offices.

Senator COCHRAN. I don't think I have any other questions.

Senator BREAUX. Let me just for a second pursue something that I think Senator Cochran touched upon.

If the bank in receivership is merged with someone from outside of that district, borrowers are going to be concerned about local control. That's really always been part of this lending institution. How are the people in those three States going to have any kind of

local control if part of the lender is located in another district? What's the mechanism to ensure local control?

Mr. THOR. Remember, there have always been significant influences from outside the district. For example, most of the funding is done through a mechanism on the east coast.

That helps to set the basis by which local control is defined and established.

Senator BREAUX. I understand that, but what I'm talking about is the local borrower coming in and having a board that's based in some other entirely different district setting up the regulations as to whether he's going to qualify for that loan at whatever interest is the marketable rate.

Mr. THOR. Again, in all the Farm Credit System districts, including the Jackson District and the new group, there are options. I think it's premature to comment on all the options, because the receiver is looking at many; more, frankly, than even I may be aware of.

But the Jackson District borrower is going to be part of an association with local offices and the borrower is going to have much more control than he had last week.

I am not prepared to discuss all the options today. But, there are numerous options available, including dealing with some of the groups inside the Jackson Federal Land Bank District.

So, again, the receiver will be working with FCA and the Assistance Board will stand ready to facilitate that process as required. I can't really clarify it any more than that.

Senator BREAUX. Well, I just think that that's an important point. And I know that the members of the committee are going to be following that to make sure, because we're going to be hearing that request from our local borrowers, that they still retain some kind of local influence and control.

It is my understanding that under the act which we passed in 1987, when the Assistance Board certifies an institution for assistance, that the two things the Assistance Board had to do was to provide assistance which would, in effect, be in amounts sufficient to maintain 75 percent of the par value of the stock, number one, and also to protect borrower's rights, including redeeming their stock and getting paid back.

The Assistance Board certified Jackson, but the assistance that was provided was what you termed limited assistance. It didn't do either one of those two things.

And my question is why not, because it looked like the act was pretty specific? If they were certified, assistance was provided, this is what it was to be used for.

Mr. THOR. We have provided limited purpose certification so that the bank could meet its maturing debt obligations.

Senator BREAUX. That's what I was looking for, a definition of limited assistance.

Mr. THOR. We believe we have the authority to do that and have stated that many times. But on Saturday we did certify the Jackson Bank and receiver.

And as Mr. Naylor has testified, the receiver will be following all the borrower rights provisions. The Jackson District now qualifies

for the FmHA demonstration project regulations that were issued today.

Senator BREAUX. I appreciate that, but what I'm getting back to is when you first got into it, when you first provided assistance when was that? February?

Mr. THOR. We provided initial assistance in February.

Senator BREAUX. $25 million and a followup of $5 million in May?

Mr. THOR. I believe so.

Senator BREAUX. But neither one of those amounts was for the purpose of guaranteeing the stock at 75 percent of its value nor for providing for the retirement of borrower stock was it?

Mr. THOR. That was to allow them to get back to a positive capital position so they could roll their stock.

But it was a limited purpose certification in that we signed an agreement with the land bank that allowed them to do that and keep on—business as normal.

Senator BREAUX. I appreciate what you're telling me, but I can't find where limited purpose assistance is anywhere in the act.

I'm just saying we're doing it now, but we're doing it for a receiver and we didn't do it for the bank during that long period of time.

Mr. THOR. Senator, in section 6.5 [a][4], it says, "Provide assistance by such other methods as the Assistance Board determines appropriate."

We used that section in determining the limited purpose of certification.

Senator BREAUX. Ingenious. [Laughter.]

The requirement on the stock is an issue that I think that throughout our hearings and our debate and the markup session—the whole purpose was to provide that assistance, to guarantee that stock at least at 75 percent of par value.

So, the very first grant of assistance by this Assistance Board didn't do that. It was for other purposes, other than to provide that 75 percent guarantee of stock value.

And the discussion in the markups and in the conference, it seemed, that assistance was going to be used to guarantee those borrower's rights and to be able to retire their stock and to guarantee their stock at least at 75 percent of par value.

I appreciate the timing of this, because it's almost—as soon as the ink was dry on the bill, the first one comes in.

But the two grants of funds, $25 million and $5 million, were not for that purpose. They were for other purposes as deemed appropriate by the Assistance Board.

And that's what gives people some concern, because some people would say that had we done that to the bank instead of now doing it for the receiver, we would still have a bank.

Mr. THOR. Well, Senator, the Assistance Board had been in operation at that time less than 4 weeks. We were dealing with a number of very troubling options, including who was going to pay back approximately $120 million worth of debt, which would have required invoking joint and several liability. As you all know that was one of the principal things we were all trying to avoid in the legislation.

So, we had to make a very quick, but, we thought, a very firm call in buying enough time for the Jackson Federal Land Bank and its management to attempt to get together a workable and viable plan in that district.

And for that reason, we invoked the section I have just quoted to allow us to do that.

Senator HEFLIN. Basically what you're trying to do is help the System rather than help the Jackson Federal Land Bank?

Mr. THOR. No, I would disagree with that, Senator, I believe it was, indeed, quite the contrary. Several members of the board of directors and management with whom we were meeting kept asking for more time to prepare the plans. So, indeed, I would say, it was really quite the contrary.

Senator BREAUX. Mr. Thor, we thank you. I know it has been a busy week for you as well as for the FCA board members.

Senator Exon from Nebraska has just joined us and perhaps he has some comments that we could benefit from.

Senator EXON. Thank you very much, Mr. Chairman. I appreciate your allowing me to come in. I would like to ask a question of Mr. Thor.

I believe that, Mr. Thor, you were out to Nebraska recently, were you not, on some problems with regard to the System out there?

Mr. THOR. That's correct, Senator.

Senator EXON. Would you please give me your version, I have written to the members of the committee, when the restructuring bill passed with regard to what the intent was.

You were out there and there has been some discussion pro and con with regard to whether or not it is timely for those people responsible in the Omaha area to be asking for assistance. As I understand it, they have fallen below 75 percent and are supposed to correct that by some time in July with a merger that supposedly would bring them back into compliance with the law.

In the meantime, they have not made a request for assistance. Could you give us your version of where you are coming from on this?

Mr. THOR. Very good, Senator. Let me point out, before I get started, that I have stated several times it is the policy of the Assistance Board not to comment on requests that are before the Board. As the FDIC, the Board of Governors, the Federal Reserve, and the Comptroller of Currency do—we do not publicly comment.

But there have been a number of news stories about Omaha, and I would like to clarify those if I could, Senator.

First of all, the Omaha bank has submitted to the Assistance Board a number of documents related to a proposed request, which as they have stated, will be forthcoming.

The Omaha District has also reported in the press that they have ongoing meetings with not only their borrowers, but with the PCA's and all the other members of the group in the Omaha District.

I've been out there three times to visit with the Board, as has been reported by the press, to discuss their business plans. Specifically, I was out there to talk about the borrower stock issue. As you know, in the O'Neill and Valentine Districts we took affirma-

tive action approximately 2 months ago to ensure that the receiver for those districts had the money to pay back the borrowers.

Omaha is in the process of considering whether or not to apply for assistance. They have been sharing, as required under the act, as the press has reported, their business plans with us.

Senator EXON. Well, I recognize the position that you're in. We get caught in some of these positions ourselves, as U.S. Senators who have some responsibilities in these areas, especially since we passed an act.

Do you feel that the Omaha people have been proper in not requesting assistance, since they fell below the 75 percent figure and have acknowledged that they are below that figure at this particular juncture?

Mr. THOR. Senator, I do. I believe the applications for assistance needs to be a very thoughtful, well-reasoned, financial approach.

Farm Credit System banks are very complex institutions. In fact, the Omaha District, Jackson and Louisville are some of the largest financial institutions in the country.

And to get together a workable, reasonable plan approved by all the boards of directors in the borrower groups is not something you can do in a week or two.

I believe the Omaha District is working with diligence to do that. Only time will tell whether that is the case. They are going ahead with plans for the merger to happen on schedule as required by the act.

Senator EXON. What reference did you make?

Mr. THOR. Senator Karnes gave us an update on Nebraska here at the hearing. The bottom line is that as the Omaha District, its bank, the PCA's and the borrowers in that area prepare their plan, they are going ahead with those merger plans that are required by the 5th of July.

Senator EXON. And if the merger plan goes through, could you hazard your opinion at this time on the overall solvency of the overall system in Nebraska at this juncture?

Mr. THOR. I think we are prepared to ensure that the borrower stock is whole. The overall solvency question is one that we'll have to look at very closely when we see all the facts before us.

And we just haven't got those facts before us yet.

Senator EXON. Mr. Chairman, may I ask whether or not there has been discussion today—and I am sorry, I was tied up on the floor with the INF matter and could not get over to this particular matter—I take it that you did discuss in this hearing today some potential difficulties with some of the Farm Credit Systems and you focused on one in the South. Is that right?

Senator BREAUX. The Senator is correct. And I think in his opening comments Senator Boren had indicated, that at the request of a number of members of the committee, that they would have an opportunity to focus on some of the other areas that are experiencing problems.

Senator EXON. Was it the general thrust of the testimony that the subcommittee has received today that the bank in the South—is that the bank that is in the most financial difficulty and stress and strain today?

Senator BREAUX. Let's put it this way, they're the only one that is in receivership. [Laughter.]

Senator EXON. I don't like to be the bearer of bad tidings. I just think it fundamental that we, as Members of the U.S. Senate, and particularly this subcommittee look very carefully and make sure that we're not being hoodwinked by any of these people.

I, for one, felt that there was an awful lot of hoodwinking going on in the last 2 or 3 years. We were assured time and time again, "Oh, we aren't going to need any bailout. We're in good shape. Everything is fine."

Well, everything wasn't fine and all that I'm interested in making sure of is that those that we have helped and give offers through assistance now act on those in a timely fashion and not find ourselves in the almost desperate situation that we were in when the bailout took place.

I thank you, Mr. Thor, for your answers to the questions and I'll be pursuing this through the committee as to making a determination of what seems to now be a difference of interpretation by the banks in Omaha and some out there representing the farm groups that feel that they are not proceeding in a timely fashion.

But I take it from your comment today that you feel you are proceeding in a timely fashion.

Mr. THOR. Again, Senator, I believe they have met all the requirements of the act. We are diligently working with them and their business plans to ensure that the act is carried out and fully implemented.

Senator EXON. Thank you and thank you, Mr. Chairman.

Senator BREAUX. I think a point can be made that an awful lot of other banks can learn from the situation in Jackson and the methodology that was used to take care of the problem. Thank you, Mr. Thor.

I would like to welcome up together, Mr. Robert Carson, who is a member of the Board of Directors of the First South Production Credit Association; and, David Waide, who is a member of the Board of Directors of the 5th District Farm Credit Board in Mississippi.

STATEMENT OF ROBERT A. CARSON, MEMBER, BOARD OF DIRECTORS, FIRST SOUTH PRODUCTION CREDIT ASSOCIATION, LAMBERT, MS

Mr. CARSON. Thank you, Mr. Chairman. Let me express my personal appreciation to this committee for the work they did in ramrodding the 1987 bill.

Working with the staff of these three States was a real pleasure and I think we accomplished a lot of what we were looking for.

Mr. Chairman, my name is Bob Carson. I am a cotton farmer from the Mississippi Delta and a member of the Board of Directors of First South PCA.

Last week, I had a complete statement to give you, sir. It would have been submitted in great detail and a lot of answers to questions that still hadn't been asked—would have even been in to you.

But with the actions of 4:30 last Friday afternoon, we throw that out the window and I come to you to make a brief statement on the conditions that exist in our district and the concerns that we have.

I'll tell you and the Senators from all over the Midwest and the South and the West and the Southeast, if we had 80 cent cotton and $8 soybeans, we would have taken care of a lot of these problems ourselves. You wouldn't have to worry about it with an Assistance Board. Let the market take care of it.

Those things we don't always have. We can't have. But when we have them, we do make progress in this Farm Credit System situation.

So, a lot of our problems are not just from bad management, maybe some bad decisions, but it's a bad economy for agriculture.

I do not wish to try to second guess the actions that were taken by FCA and the Assistance Board last weekend. I'm here to tell you that we want to work with those men, those agencies, we want to cooperate and we want to become a part of the solution, a part of the answer.

And if we can show ourselves to be fit performers. If we can show ourselves to be able to perform some of the functions that the closed bank has been doing, then we want a shot at it. We want an opportunity to do it.

Now, let me tell you, we've been operating under joint management and joint services in the field. We've come a long way. First South Production Credit Association was the first one to come forward with the concept of one PCA for an entire Farm Credit district.

We put that together, we worked well with it and then in time, the Land Bank Association has come in and has been working with us.

The Land Bank Association has been carrying almost 50 percent of the cost of the field operation. All of a sudden, this is jerked away from us, it will be on a day-to-day basis.

But I ask you gentlemen to analyze honestly in your own mind, if you were a Land Bank Association employee on a day-to-day basis, would you still be looking for that job or would you be looking elsewhere for a job?

We have lost a lot of confidence in the area of employees. I cannot blame them. It's a problem that we're going to have to face up to, but we cannot afford to lose these people. I want the committee to be well-aware of that.

We're concerned about the operating costs. I mentioned the fact that we have almost 50 percent of our cost operating in the field and the Association level was born by the land bank side. And this is not going to be.

So, obviously, even though they can say here with all honesty that the FICB is not going to be affected, the FICB is going to be left alone, I can tell you gentlemen that the FICB PCA has got some tough days ahead of it, because half of the rug has been jerked out.

Now, I'm not going to disagree with what they did. A receiver might have been the most cost effective way to come in. And as I look back over the last few months, that was my opinion, that that would be done.

But I would also ask them to come in with a good bank/bad bank concept. And one bad bank will serve the whole United States, take care of Omaha, Seattle, these others.

Take those nonperforming funds and put them over there. They're going to have to be handled somewhere. I never was able to determine from the men speaking here why it was cheaper to go this route and that there wouldn't be any more costs.

Those nonperforming loans are still out there. Those nonperforming assets, those costs are still there and they're going to have to be picked up.

We've got some real tough things and some tough questions that I think possibly could have been answered. But the operating costs that we have are a real concern. We're concerned about borrower confidence.

Now, when the "Jackson Daily News" comes out on Saturday morning and tells Farm Credit System people referred to here earlier, Senator, by you, that borrowers should look elsewhere for credit, we don't need those kind of things. We just don't need that kind of help.

Our borrowers have run off. Our confidence has been beaten away and anybody who's had an opportunity to move away, has done so and gone to an alternate source of financing.

We get a viable long-term lending operation going, we're going to get these people back. But we're going to have to establish confidence.

And I think we can do that working within the agencies that we have set up now, but I'm not sure that we're going to have to go to Columbia or go to Texas to get this done.

I believe we've got the expertise in our district. I'm not saying we're going to have a bank there. I'm not saying that at all. I'm not saying whether we're going to discount. I'm not trying to tell this committee or the FCA where our checks will be mailed in payment.

I'm simply saying that I believe there's expertise in the FICB Land Bank Association people and PCA Association that can take on this responsibility and can be chartered and can make long-term loans. We would like to give it a try.

But I don't think it's any secret here in Washington that the 5th Farm Credit District is not looked upon by very much favor from FCA.

We seem to have been a thorn in their flesh for quite some time and through actions—why, I do not know. But we just haven't been the favorite child and its cost us dearly in confidence.

I'll admit we haven't shown the strongest balance sheet. We have problems, but the area we come from, I think, is doing pretty well. But we would like a shot at handling or servicing these loans.

If nothing else, if you're going to put them somewhere else, then let us get a servicing fee to handle them. It would defray our costs and make it possible to keep more service outlets. No more than we can afford, but enough out there to serve the borrower.

The question has been asked here over and over again and you didn't get a straight answer, any of you men, about what kind of representation we would have.

I know exactly where Senator Breaux is coming from—that these people elect their grassroots and they elect their directors, the stockholders do. If they're thrown off into another district, into Columbia or Austin, Texas, how is this going to have any influence upon a bank that would be 10 times stronger and you come in with a broke bank you might say and it's just not going to have much influence where they're going. We need to address that issue very completely.

We're concerned about the loan servicing. Obviously, if we're going to take these things away, who's going to service the loans. We've been accused of not servicing the long-term side of it properly.

That's been a real problem, but it's—the problem I think was—not because we didn't want to do it, it was because of the nature of the times. We couldn't make any new loans in that area and it was just difficult to try to service, to train and to put together association staff in the field.

The short-term measures to be considered—but in the long term, I think we can offer a positive contribution on the FICB PCA side.

We don't want the fire sale approach. You can imagine if we got some loans that—when they go out to appraise them—and they have us go make a mammoth sale in this area—that it's going to be reminiscent of the days when FmHA went out there and absolutely tore up land prices by unloading everything around. And this can happen if these people do not show some restraint in how they dispose of that. Because an appraisal on a piece of property that will be a good loan, if you have a fire sale out there and bring property values down, his appraisal comes down and the first thing you know what's been a good loan is a bad loan simply because there's too much land on the market at one time.

There are ways to do this. I talked to Mr. Thor about this 2 weeks ago and encouraged him that if he sent someone in to please use restraint and not be reminiscent of the days when FmHA used to do it.

Mr. Chairman, the last thing I want to say to you is that I think it's unreasonable, the 7 percent capitalization, the Farm Credit Administration has set on these new banks and the capital we're going to have to raise.

There's no way that we can do that in a 5-year period of time. I think we could come up with 4 percent probably, maybe even up to 5, but I think you're asking a banking institution unfairly to raise 7 percent of capital when the commercial banks are not required to have that much.

As Mr. Naylor said, while we are in a highly risky business and we do not have a diversified portfolio, that's not our choosing.

Our commission is to serve the farm interest. And if farm loans is all we can make, then give us a chance to make them and give us—as Mr. Whitten always told me—a fair advantage and that's all I'm looking for is just a fair advantage in this respect.

Mr. Chairman, I appreciate your interest, your support in holding this hearing and it's been most beneficial and I'm just sorry that many more in the 5th District could not be here to see how concerned you have been, and are, and the questions that you have

asked. I think they would be very proud of you and I want to give you my personal appreciation for what you've done. Thank you, sir.

Senator BREAUX. I want to thank you for being here, Mr. Carson. I know it hasn't been easy to be up here and all the members of the committee have really been following the situation over the weekend with our staffs.

This is the first time this has ever happened and, of course, it's most serious. We thank you for being here. Without objection, the statement of Mr. Robert Carson will be placed in the record in its entirety at this point.

[The prepared statement of Mr. Carson follows:]

Statement by

Robert A. Carson

Member of the Board of Directors
First South Production Credit Association

Before the

Subcommittee on Credit

Committee on Agriculture, Nutrition & Forestry

United States Senate

May 23, 1988

Mr. Chairman and Members of the Subcommittee:

I am a cotton farmer from the Mississippi Delta and a member of the First South PCA Board. I am testifying today on the Board's behalf.

I'd like to begin by thanking the Members of Congress for passing the Agricultural Credit Act of 1987, above all for ensuring that the stock investment of borrower/owners of Farm Credit institutions is protected.

Last week, I had a complete statement prepared for the record and was prepared to talk to you about the joint efforts which we had

underway in the 5th District to develop a common plan to be presented to the Assistance Board. Our objective was to ensure borrower control and one-stop delivery of competitively priced credit throughout the 5th District. Obviously, the events of Friday have substantially changed the focus of my statement.

Mr. Chairman, let me begin with just a word or two about the general agriculture situation in our district. If we had $8 soybeans and 80 cent cotton, a lot of the problems that we've been experiencing would go away quickly.

I'm not here today to second guess the action taken by FCA and the Assistance Board last Friday. We've got to go forward from where we are. As a representative of the First South PCA, we are going to do whatever is necessary to meet the needs of our borrower/members. We are going to work with the Receiver as he unwinds joint management, and as issues arise that have an impact on short-term credit delivery.

I'd like to talk about a few of those issues with you:

o We're concerned about operating costs. Because we have successfully used joint management and provided one-stop credit delivery through service centers, we have some work ahead of us. The FLB provided nearly half of the funds to meet operating costs of these centers. While we understand that will still be provided on a day-to-day basis, we've got to start planning for

the day when it won't be there. We're going to have to be more efficient.

o We're concerned about borrower confidence. In our district-wide PCA, we think we've bottomed out. Volume is beginning to increase once again because we're offering competitive rates. Nothing should be done to raise borrower concerns or cause undue alarm.

o We're concerned about loan servicing. Whatever is done for borrowers should ensure the continuing of local loan servicing and borrower satisfaction. There must be a personal relationship between the borrower and loan officer. I was very disappointed at the Jackson Clarion-Ledger story on Friday which said that FCA was urging good borrowers to seek credit elsewhere. That's the last thing that we should be doing!

o We're concerned that any short-term measures to provide mortgage credit take into account the service-center concept which we have developed and which has worked well. We hope that any such measures can be unwound if another bank is chartered.

o We're concerned about service center staff. We've got some very capable staff who have done their best to provide good service to borrowers. These people should not be lost as we try to solve the problems.

o We are very concerned that there not be a fire-sale approach to liquidating assets. All borrowers in the three-state area will suffer if land is dumped on the market. This will jeopardize the recovery which we have underway.

o We hope that bondholders will not become alarmed. We cannot afford to have our cost of funds increase because that directly impacts borrowers. We need to keep our rates competitive.

Lastly, Mr. Chairman, I want to make a few comments about capitalization. Just as these issues I've mentioned can hurt borrowers, so can FCA's proposal on capitalization. I'm not going to lay out all the arguments, because we don't have time. But I will tell you that forcing every institution to reach a capital level of 7 percent in a five-year period is next to impossible, given the other problems which we face. This will make any recovery very doubtful at best.

Mr. Chairman, we appreciate your interest and support. We hope that you will watch over what is happening in Jackson to make sure that the borrower-owners are not the ones who get hurt by this action.

STATEMENT OF DAVID WAIDE, MEMBER, BOARD OF DIRECTORS, FIFTH DISTRICT FARM CREDIT BOARD, WEST POINT, MS

Mr. WAIDE. I really would like to give you a general overview of what my prepared statement is rather than read anything or give any lengthy discussion of it. I would be glad to field any questions regarding the testimony.

Briefly, and I think it's already been discussed today that in the late 1970's the commodity prices escalated and at that time we were able to make loans in the Fifth District and we loaned a good bit of money on land.

Land prices escalated and as times continued with various governmental policies and whatnot, the bottom fell out of the farm economy.

And we had a downward trend in commodity prices which was followed by land. And, of course, that's the Land Bank's primary asset or it's all the collateral they have on most loans.

So, as a result of this and as a result of the regulatory agency's requirement of issuing different bond maturing dates, ended up with an awful lot of high cost money in the Fifth District.

I probably would point out here earlier in Mr. Thor's testimony, especially, he alluded to board and management of the bank.

And I would remind you that we've been under joint management in the Fifth District and the other two banks are solvent.

So, perhaps it was just the luck of the draw in that particular case, but we had to be in the market at a time when bond costs were extremely high and our fiscal agent recommended at that time, even though I was not a part of the District Board, that we issue these high cost bonds on a nonrecallable basis.

They said that the premium on the bonds would be too high to make them recallable. So, perhaps there was some bad advice in that situation.

I would talk a little bit about some of the problems that Mr. Thor alluded to regarding some of the things that we had not been able to solve in the Fifth Farm Credit District, the stock issue.

We had repeatedly tried to resolve that issue. We had written various letters at different times regarding how we could go about it, because we felt like we were not complying with the intent of Congress and with what the law required.

We were told that at one point we could issue stock and we tried to get FCA's permission to do that and they said without adequate capital, you cannot, you'll be in violation of the regs.

I believe there's an assessment against the directors of $5,000 a day, if you are in direct violation of the regs. So, that alarmed all of us.

And until we could get permission from FCA as well as cash from the Assistance Corporation, there was no way that we conceivably could issue or retire the stock that we had.

Another thing that I would also address is that since January, and that's when I came onboard—as a matter of fact, I missed the January Board meeting as a result of a tornado we had on the farm.

At any rate, we started with myself, a new member, along with two others in January trying to address many of the problems that he cited today.

We had met on separate occasions with Columbia and Texas, trying to get some type of agreement worked out with them to make loans to the borrowers in the Fifth Farm Credit District.

And we were just unable to do so. It was—I guess probably we had too many attorneys involved in different aspects of it. But at any rate, we had not, but we were very close to a solution, I suppose.

The other thing that I would like to address is the fact that in early February, when we had a meeting with Mr. Thor regarding the $25 million in temporary assistance, that he acknowledged that we had and it was given for special purposes—he told us at that time to proceed with the hiring of a CEO for what would have been, we thought, the merged farm credit banks in July.

We did that. We advertised throughout the System and we had, I believe 13 applicants in all, finally, before the committee met to consider the various applicants. Two of them had withdrawn.

The Board proceeded though and did hire Mike Davis who had a lot of experience in various aspects of Farm Credit System work and he put together a plan that would have ultimately cost in the neighborhood of $190 to $240 million.

The plan was not complete, but it didn't lack much of being complete on Friday. We were hoping to have it up here today.

The plan ultimately would have cost the System borrowers $100 million. It would involve about $330 million.

Based on what I've been told by other people, the receiver being placed there is probably going to cost the System borrowers ultimately $600 million.

So, the only request I would have of you gentlemen is that you carefully monitor the situation. I believe that the Fifth Farm Credit District perhaps has been singled out and—justly or unjustly.

I have serious reservations as to whether or not—that if the receivers were placed in several banks that the $4 billion that has been allocated would be sufficient to cover the cost of getting the banks back so that they could loan money.

And I would ask that you carefully monitor the FCA and the temporary Assistance Corporation to see that they stay with the intent of the law. Thank you, gentlemen.

Senator BREAUX. Without objection, the statement of Mr. David Waide will be placed in the record in its entirety at this point.

[The prepared statement of Mr. Waide follows:]

Statement by

David Waide

Member of the Board
Jackson Farm Credit District

Before the

Subcommittee on Credit
Committee on Agriculture, Nutrition & Forestry
United States Senate

May 23, 1988

Mr. Chairman and Members of the Subcommittee:

My name is David Waide of West Point, Mississippi. I have a cow-calf operation and also grow cotton, corn, soybeans and wheat. Prior to being elected to the at-large position on the 5th District Board in January of this year, I served since 1978 as a director of the FLBA of Jackson. I am also a commissioner of the Clay County Soil Conservation Service and former commissioner of the State Soil and Water Commission of Mississippi. I am testifying today as a representative of the

District Board of Directors.

The events which took place last Friday were the culmination of many years of problems, not the least of which were the agricultural policy decisions of the late 70's which severely hurt commodity prices and land values. We also experienced the runoff of more than $1 billion in good loans, starting in 1985 when the Jackson Land Bank was directed to raise interest rates, and the requirement that our debt securities be spread over various maturities. As a result, we ended up with a lot of high-cost debt and borrowers who were unable to repay their loans.

In early February, the Jackson District Board met with Eric Thor, President and Chief Executive Officer of the Assistance Board, and later that month, we received $25 million in temporary assistance. He told us at that meeting to proceed with hiring of a CEO for the Land Bank. We did so, notifying him of all of the candidates, and later the three finalists. In late April, we hired Mike Davis, a Farm Credit System leader with more than 20 years experience, but then we were told that there was no hurry in bringing on a CEO.

Mr. Davis brought leadership to the staff and the District. He was in the process of finalizing a plan that would have provided for an estimated $190 - $240 million in assistance from the Assistance Board. We thought this was in line with the intent of

Congress and the Agricultural Credit Act of 1987. The total plan involved assistance of an estimated $330 million, approximately $100 million of which would have been contributed by 5th District borrowers.

It was our opinion that this was the least-cost approach, not just for the Assistance Board, but for the System as a whole. Our best estimate was that a liquidation of the Land Bank would ultimately cost the System between $500-600 million.

Today, we must move forward. The decision to liquidate the Land Bank cannot be changed. I would hope that this Committee would continue to watch the situation in Jackson very carefully. Specifically, I want to raise the following concerns:

- service to borrowers must be maintained. The district cannot afford to lose any more of its high-quality borrowers for any reason;

- sales of acquired property should not result in major drops in land prices. Any precipitous declines in land values will hurt the other institutions of the System; and

- borrower and investor confidence cannot be sacrificed.

Mr. Chairman, agriculture plays a significant role in this economy. Not only does it provide food and clothing, but we

export more than one-third of our agricultural produce. For that reason, we must ensure that the producers of food and fiber have an efficient provider of fairly priced credit. We have made a sincere effort to provide needed services to the farmers in the 5th District.

We Worked to Restore Delivery of Long-Term Mortgage Credit in 5th District. Efforts began in early December to work out a means for continuing to provide long-term credit to farmers in the 5th District. The District Board proposed on December 17, 1987, to allow First South PCA to make mortgage loans to eligible FLB borrowers.

FCA denied this request on January 22, 1988, indicating that this was in conflict with the Farm Credit Act.

Efforts also began in December and continued in January to allow the Texas and Columbia District Federal Land Banks to establish a loan origination facility in the District until the Jackson financial problems were resolved. Columbia corresponded with both FCA and the Assistance Board on this issue.

On April 20th a Memorandum of Understanding was executed by the three District CEOs to work out the specifics of such an arrangement. This past Thursday, May 19th, the 5th District Board authorized management to enter into necessary agreements to finalize plans so that the long-term credit needs of farmers in

the three states can be met as quickly as possible. Meetings would have been held this week to complete the necessary agreements.

We Attempted to Get Approval to Retire Borrower Stock. As you know, the District halted retirement of borrower stock on December 8, 1987. On March 22, 1988, the Assistance Board wrote to Jackson management that since it provided the $25 million in assistance, there was no reason why the District should not retire borrower stock at par.

Mr. Chairman, because you have asked us directly to respond fully and completely on this issue, I would refer this Committee to two documents. The first is entitled "Certification of Eligibility To Issue Preferred Stock for Limited Purpose", dated February 26, 1988, and signed by Eric Thor, President and Chief Executive Officer of the Farm Credit System Assistance Board. This document states that the Federal Land Bank of Jackson shall:

> "issue preferred stock for the limited purpose of avoiding default on maturing consolidated or Systemwide notes, bonds, debentures, or other similar obligations for which the Jackson FLB is primarily liable and for maintaining collateral to support such outstanding obligations."

The second document is the text of the Agreement entered into by

Jackson and the Assistance Board. That agreement states in paragraph 5:

> "The Jackson FLB agrees to use the Note... only for the purpose for collateral to support the issuance of consolidated or Systemwide notes, bonds, debentures, or other similar obligations (Systemwide obligations) for the purpose of repaying or refinancing outstanding and maturing Systemwide obligations for which the Jackson FLB is primarily liable, or for the purpose of maintaining collateral to support outstanding obligations."

And this agreement also clearly states that the Jackson FLB must comply with regulations and directives issued by the Farm Credit Administration.

Mr. Chairman, we were instructed by the Assistance Board to indicate to them when we believed that we were unable to retire borrower stock at par. On April 8, 1988, our CEO, Jim Toft, wrote the Assistance Board that the FLB would need an additional $3 million in order to retire borrower stock between the date it as frozen--December 8th--and March 31st.

That same day, the Board of the FLB formally adopted a resolution which requested that the Assistance Board certify an additional $5 million in assistance for collateral to support debt

obligations as well as another $5 million for the retirement of borrower stock through June 30, 1988. This request for a total of $10 million in assistance was communicated to the Assistance Board on April 8th.

On April 28th, the Assistance Board provided the district with draft documents incorporating the requests which we made some three weeks earlier. This was the first time that the Assistance Board recognized that Jackson needed a separate agreement and specific assistance in order to retire borrower stock.

Unfortunately, less than a week later on May 2, 1988, we were informed that the Assistance Board would only certify $5 million for use in maintaining access to the bond markets. We were told by Assistance Board staff that the additional $5 million certification for borrower stock redemption would not be issued before mid-May.

On May 19, 1988, the chairman of our District Board, John Lowery, Jr., communicated the Board's request that the Assistance Board provide assistance **specifically** to retire borrower stock and directed management to immediately begin such retirement as soon as the Assistance Board acted. We never received a response to this request.

Regarding Implementation of the Agricultural Credit Act of 1987, it is our position that the provisions of the Act which were

adopted by Congress this past year are--for the most part--sound and constructive. We are greatly concerned, however, about the manner in which some issues are being handled, specifically relating to the capitalization of the Farm Credit System and second the manner in which financial assistance is provided.

With respect to capitalization, the proposal which the Farm Credit Administration has put forward to have minimum permanent at-risk capital at a 7 percent level within five years is out of the question in this district. We are still formulating our official response to the FCA proposal, but basically it is this: while we agree that at-risk capital is necessary for all financial institutions, to adopt a business recovery plan which is achievable is not possible if the very first action that we must take results in raising interest rates to borrowers by from 1-4 percent!

Again, I can only refer this Committee to what happened in the mid-80's when our rates went up and everyone else came down. We experienced the greatest run off of our best customers in history. If we took such an action today, we would certainly lose our high quality borrowers who remain, and, for the borrower who continues to be in financial trouble, we will drive him into bankruptcy or foreclosure. I don't believe that is what Congress intended.

Our overriding concern at this time is to do what's best for the farmers of this District. We still believe there should be a locally-owned, borrower-controlled lender in the 5th District. With your concern and involvement, hopefully we will be able to achieve that objective.

Senator BREAUX. Thank you, gentlemen, for being with us. The question of the cost of liquidation and receivership as compared to a new business plan is one of the issues that the committee will be following.

I would ask unanimous consent that the members be allowed to submit additional questions to the previous witnesses, members that are not here as well as those who were here during the hearing.

What do you know, if anything, of what would happen with the required merger between the FICB and the Federal land bank, which is required under our law to occur by July the 6th.

Is the receiver talking about a merger of the FICB and the——

Mr. WAIDE. I asked that particular question of the receiver yesterday. We met with him. And he says that as of Friday there is no Federal land bank in this district.

Senator BREAUX. Well, I don't think that's correct under the regulations.

Mr. WAIDE. That concerns me and I don't know, but that's the answer he gave. Our attorney is checking into it to give the Board advice.

Senator BREAUX. Well, I think the regulations of the FCA still say that the bank is chartered. It's in receivership. I'm not sure that it doesn't exist. And until it is completely terminated and the charter is revoked, it's still in existence, but it's in receivership.

Mr. Carson, the condition of the FICB and the PCA's down there, how are you going to be affected by the receivership of the land bank?

Mr. CARSON. I think the question and testimony that was here today has indicated that the FICB is going to be standing there alone.

Now, I don't know how long we can stand alone and obviously it's one thing to say we're going to let you be or you are what you are and then hope to survive.

If the land bank is moved over to Texas or to Columbia, or to Louisville, wherever it may go, obviously the FICB—that would be their intent to probably move that somewhere. But, so be it.

And I say, again, where the bank is located is not all that binding because the law says you can get down to six. But, Senator, let's keep the loan making at the local level where you know somebody you're doing business with.

You can put the headquarters of the bank anywhere you want, but let the loans be made by people who know the people they're making deals with. This, I think, is tremendously important.

Senator BREAUX. Thank you for that. Mr. Waide, I just wanted to mention that my reading of the regulation say that, "The bank in receivership shall continue as a bank, chartered in accordance with the act until such time as the liquidation has been completed and the charter of the bank has been canceled by the Chairman of the Farm Credit Administration."

That is the regulation, I'm not sure how they're going to try to handle it.

Senator Cochran.

Senator COCHRAN. Mr. Chairman, I was impressed with the comments made by Bob Carson about local control and participation

and I think everyone here realizes that we've asked that question about four different ways today and we really have not gotten a good, solid answer to it yet.

I would suggest, Mr. Chairman, that we put it in writing again and submit it to both Frank Naylor and to Eric Thor to see if we can get something nailed down for the record on that.

Because, as I understand the law, the borrowers have the right to participate in these cooperative entities. That's why they are cooperatives. That's what makes them different.

And I'm still not certain that that's the understanding on the part of the Administrators and the regulators.

In connection with the FICB and its role, I understood answers to indicate that the FICB could be—would be an eligible purchaser of the assets of the land bank. Do you see any chance of anything being put together, a proposal or a bid where the FICB in the area would end up with land bank assets? Is that a realistic option?

Mr. WAIDE. Quite frankly, Senator, I think FCA has predetermined where the Fifth District is going. I don't think that the FICB would be giving due consideration. I'm glad to hear today that it is an option, though.

Senator COCHRAN. What's your reaction to that, Bob?

Mr. CARSON. I think he's going to give us a shot at it, but I think since he has turned us down before, that he is going to say that we are not financially strong enough to handle this type of operation.

That's the reason I was making the point a little bit earlier, that if on a temporary basis you could get some discounting with another Farm Credit district, get the land bank and long-term lending back in place, then give us a chance to service those loans for that district.

And then in time get the loans back that have been moved over to that District, simply the bank can be located where you want it, but if you've got the loanmaking authority at the association level and it's out there in the field where the people have access to it, we can make the loans.

But it's going to take a little time. I think we can give them a plan, but I don't think he'll buy off on it, because he's said several times here that we were marginally in the black and I just feel like maybe FCA would like to see the Fifth Farm Credit District go away and not come back.

And there's even some concern out there that they're going to break up the three States and maybe send Alabama and Mississippi one way and send Louisiana the other.

So, if that, in effect, is done, it's going to be hard to put it back together. We would like a shot at it. We will make an honest approach at it and we'll certainly consult with you on any figures or plans that we submit to him if he gives us a chance to do it, yes, sir.

Senator COCHRAN. One of the things that I wanted to be sure we did today was to ask the questions that some of you wanted asked and to get answers to some of the questions that are still outstanding about how this is being handled by the regulators and by the Administrators.

If you were developing a question to be submitted for the record, what would it be, so we can see that it's asked?

Mr. WAIDE. The one thing, I think, Senator, that would concern me the most is how they're going to dispose of the assets.

If they're going to fire sale them it's going to disrupt the Fifth District.

We were beginning to see a turnaround in the farm economy in the Fifth District. Land values have stabilized and the AV of the property that we had in special assets, the sales indicated that we were accurately appraising it.

The fact is, I believe, the average on the sales—on one particular sale was 102 percent of appraised value and on another sale it was 106 percent. So, if anything we were slightly underappraised at this point.

And I would be very interested in seeing how they're going to dispose of the assets, those parts that are in SAG and acquired properties and this sort of thing just to see if there is an orderly liquidation plan.

Senator COCHRAN. Mr. Chairman, I ask unanimous consent that I may be permitted to submit that question to the other witness.

Senator BREAUX. Without objection.

Senator COCHRAN. Thank you, Mr. Chairman.

Senator BREAUX. Senator Exon, any questions you would like to ask?

Senator EXON. Thank you, Mr. Chairman. What year, gentlemen, would you just guess would be the peak year for land values, farmland values in your area? What was the peak year and what was the lowest year?

Mr. WAIDE. The elevation started in 1979 and I suppose it peaked in 1984 or 1985.

Senator EXON. Well, between, let's say, 1984 for discussion, when did the low point—when was that, 1987, last year some time.

Mr. WAIDE. The latter part of 1986. We sort of have an interesting situation I suppose. In our district, if we draw out the Black Prairie that was just farmed, our soybean land primarily, the drop there was a lot more dramatic than it was in the Delta.

And on an average in that soybean area, we probably would have seen something like a 60 percent decline. But over the area as a whole, I would say that the decline was more in line with 55—45 to 50 percent, I guess would be——

Senator EXON. That's pretty indicative of Nebraska and other places that I am familiar with.

Mr. CARSON. Senator, it was 20 to 60 percent. But those percentages, of course, can be deceiving, because it depends if it went up on the front end as to how much it came down.

And you had some land that doubled in price and when loans were made on it, that agency made that loan when that land was doubled in price. They bought it. They bought it when they made the loan on it.

So, it was in that range of 20, but David's exactly right. His 50 percent is a very close figure.

Senator EXON. I would like to ask the staff a question, if I might, Mr. Chairman. What is the total portfolio of the Farm Credit System? One time I heard it was around $50 billion.

Mr. DANN. Senator, it was up around $78 billion at one time. It's down to around $56 billion now.

Senator EXON. You listened to the testimony today, some of it that I didn't get in on. Let me ask this question, when did the Fifth District go into receivership?

Mr. CARSON. Friday afternoon, sir.

Senator EXON. Previous to it going into receivership, was there a request for assistance? I assume that the stock must have fallen below 75 percent of value. Was there a request by the Fifth District for assistance from the Assistance Board under—that was available when the stock fell below 75 percent?

Mr. WAIDE. Yes, sir, we've—according to Mr. Thor this afternoon, we made, I believe, three different requests to him. The first—well, we asked to be certified in early January.

But the plan that was actually submitted asking for assistance, I believe, the maximum amount spelled out from the Assistance Board was $240 million. That is the maximum.

Senator EXON. Have any of your farmers been helped with that special clause in the act that when their stock fell below 75 percent of the value, and if assistance was granted, there were some benefits that might accrue to help them get back on their feet? Was that used in the case of the Fifth District?

Mr. WAIDE. I'm not—is that the FmHA project you're talking about?

Senator EXON. I'm talking about the provision in the act that I was alluding to earlier when I asking Mr. Thor the questions about the Omaha situation where there are some provisions that if, when the values drop below 75 percent, the Board can ask for assistance and it can be granted. And when that is granted, it triggers some benefits to the borrowers as far as writing down of loans are concerned. And I was just wondering, has that been used in your area?

Mr. WAIDE. Yes, we organized a special assets group earlier. And this has been in place really since—long before I came onboard.

And it was just really getting up and running with the new borrower rights acts, acts that had been—regs that had been placed on us.

And we had several restructure committee meetings and restructure hearings set for the next few weeks, but, yes, that was being applied in the Fifth District.

Senator EXON. I just have one last question, Mr. Chairman, if I might. At the time of the restructuring or the bailout, call it what you will, were you people in the Fifth District area—did you feel confident at that time that you would be able to manage your way out of the difficulties that undertook—that fell your way along with a whole lot of other areas in the country? Were you reasonably confident then you could work yourself out of the proposition? Did you think you could at that time?

Mr. WAIDE. Sir, I was very confident that we could have worked our way out. The biggest problem we had, had we not been put in receivership, was not being able to make loans.

When you don't have the loanmaking authority and then your interest rate is noncompetitive—those are two things that are just impossible to deal with as far as the ongoing side of the business when that's all you do.

But had we been able to get loanmaking authority and a competitive interest rate, in talking to the various loan officers in my

area, we had somewhere between $50 and $65 million dollars worth of volume that we could put on the books fairly immediately.

Senator EXON. The reason for that question was I'm trying to determine whether the Fifth District is a special case, an unusual case, unusual hardships or whether what happens in the Fifth District might happen elsewhere.

In your conversations with your counterparts in other districts, what are you hearing and what are you learning and what's happened to the Fifth District? Could it happen elsewhere?

Mr. WAIDE. This is my personal opinion, but I honestly believe that it's the intent of various people, the regulator and TAC to see that the number of banks reduced to six in the Nation.

And some of them are going to voluntarily merge and if there are that many that don't then I think probably this could. That's just my opinion.

Senator EXON. Mr. Carson, do you have an opinion on that?

Mr. CARSON. Senator, the first thing you asked him was could we have worked out of it. We had an overwhelming debt there that was increasing so fast it would have been quite difficult.

Mr. Thor kept saying that the plan he recommended or the action he recommended he could see the end to it and he speaks in terms of some $300 million and he said the other plan would have been open ended if he had given—put some money in there and helped us to pull ourselves up by our bootstraps.

As far as conversation with what the other districts—the problems that they have ahead of them—I think if they come up with a realistic operating plan, a plan that can show that their intent is to work out of this, that they try, but there is no sense whatsoever in anybody saying they have a plan that will work if it's going to make you have noncompetitive interest rates.

There's just no need in it. There's no need that the farmer has to be the sacrificial lamb for the financial markets. If we can't have competitive rates——

Senator EXON. It isn't going to work.

Mr. CARSON. It's not going to work no matter what you do, so that's the message that I tell my friends in the other districts, try to work your own problems out, try to stay away from the regulator, because he seemed bound, bent and determined to get his hands on everything he can.

And if you can pay your bills, do anything you can to do that at a competitive interest rate.

Senator EXON. Thank you, gentlemen.

Mr. WAIDE. Could I add one thing to that regarding the Fifth District. The one thing that was a ray of hope on the horizon was the fact that all those high cost bonds would have been rolled out of our portfolio in 2 more years. A good number of them had come out in the last 2 years, and the remaining part of them would have been out of the portfolio.

Senator BREAUX. Gentlemen, we thank both of you for coming up. I know it's been a difficult week. And hopefully what we heard today is promising in the sense that we have a sense of direction and we'll make sure that we follow very carefully what the receiver does and how he carries out the directions of the Congress, too.

With that, this subcommittee hearing will be concluded. The subcommittee stands in recess until further call of the Chair.

[Whereupon, at 5:10 p.m., the subcommittee recessed, to reconvene at 10:23 a.m., Thursday, June 16, 1988, in room SR-332, Russell Senate Office Building.]

[Material submitted for inclusion in the record follows:]

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CHAIRMAN,
SELECT COMMITTEE ON INTELLIGENCE
MEMBER, COMMITTEE ON FINANCE
CHAIRMAN, SUBCOMMITTEE ON
ENERGY AND AGRICULTURAL TAXATION
MEMBER, COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY
CHAIRMAN, SUBCOMMITTEE ON
AGRICULTURAL CREDIT
MEMBER, COMMITTEE ON SMALL BUSINESS

May 24, 1988

Mr. Frank Naylor
Chairman, Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102

Dear Mr. Naylor and Members of the Board:

I am writing to express my grave concern about the size of the fees being paid to the receiver of the Jackson bank. It has been reported to me that the receiver's annual salary will be $240,000. While I have no criticism of the person selected, the fee is clearly excessive.

How can such a salary be justified when thousands of farmers are struggling to save the farm and thousands of others have already been dispossessed? In the midst of so much farm tragedy, these fees are just too high.

I also renew my request for information about the costs of furnishings and interior decorations at the Jackson bank. Farmers who can't meet their mortgage payments can't afford palaces or New York bankers' fees being given to receivers.

Sincerely,

David L. Boren
United States Senator

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DW - FYI Prep

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CHAIRMAN,
SELECT COMMITTEE ON INTELLIGENCE
MEMBER, COMMITTEE ON FINANCE
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ENERGY AND AGRICULTURAL TAXATION
MEMBER, COMMITTEE ON AGRICULTURE,
NUTRITION, AND FORESTRY
CHAIRMAN, SUBCOMMITTEE ON
AGRICULTURAL CREDIT
MEMBER, COMMITTEE ON SMALL BUSINESS

June 7, 1988

The Honorable Frank Naylor
Chairman, Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102

Dear Frank:

I recently requested information regarding reports that a salary of $240,000 was offered to Ronald Watkins for his services as receiver for the failed Jackson Farm Credit District Bank.

I am still interested in the Administration's justification of such an outrageous salary. In addition, I would like to know what qualifications were established for the position and the nature of the process used to determine whether Mr. Watkins is suitable for this appointment and meets these established standards and qualifications.

Please provide the grounds on which the Board made the decision to offer this position to Mr. Watkins, including your Board's analysis of his qualifications, experience, and suitablility.

I look forward to hearing from you at your earliest convenience.

Sincerely;

David L. Boren
United States Senator

DLB:kbw

Farm Credit Administration

1501 Farm Credit Drive
McLean, Virginia 22102-5090
(703) 883-4000

July 21, 1988

Honorable David L. Boren, Chairman
Subcommittee on Agricultural Credit
Committee on Agriculture, Nutrition,
and Forestry
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

This is in response to your letters of May 24 and June 7 regarding the receivership of the Federal Land Bank of Jackson. You expressed concerns regarding the salary to be paid to Ronald Watkins for services provided to the receivership. In considering the level of compensation to be paid, the agency was aware that individuals who are employed to dispose of the assets of failed financial institutions are often paid on an incentive basis with the compensation based on a percentage of the assets disposed of annually and considered whether such an approach would be appropriate. In light of the size of the Federal Land Bank of Jackson, which held approximately $2 billion in assets just prior to closing, it was the agency's judgment that a flat-rate salary agreement would very likely be a lesser cost alternative. Also, it was our determination that compensation based on incentives for rapid disposal of assets could conflict with the intent of the borrower rights provisions of the Agricultural Credit Act of 1987 ("1987 Act").

You also asked the agency to describe the process for the selection of Mr. Watkins. When it became apparent that receivership might be an alternative which the agency would need to pursue, a committee was formed of office heads and senior agency personnel to begin the selection process. The group determined that it would need to identify candidates with experience in the banking arena, particularly in working with troubled financial institutions, the ability to carry out the functions required in a receivership (as set forth in the FCA's receivership regulations), and sensitivity to issues involving agricultural borrowers and to the uniqueness of the Farm Credit System. Members of the group solicited input from both the FDIC and FSLIC as well as from their own past experience in the financial institutions regulation. Resumes and other background information were obtained, interviews were conducted, and references checked. This information was brought to the Board, together with a discussion of the process utilized in identifying the candidates, for its consideration.

Mr. Watkins previously functioned as an advisor to banks and bank holding companies concerning correction of both credit and financial problems. He has served as interim president, consultant, and credit workout specialist in many problem situations, including having managed a portion of the portfolio administered by the Farm Credit System Capital Corporation prior to its dissolution in accordance with the 1987 Act. Mr. Watkins' references were complimentary of Mr. Watkins' skills as a negotiator and in problem credit resolution in general.

In your letter of May 24, you expressed continued interest about the cost of furnishings and interior decorations at the Jackson bank. As indicated at the hearing of June 16, 1988, the agency has taken steps to see that this issue is given appropriate attention by the receiver. When additional information becomes available, we will be pleased to provide you with an update.

I trust that this is responsive to your questions. I appreciate your concerns on this matter and will be pleased to respond to any additional requests you may have.

Sincerely,

Frank W. Naylor, Jr.
Chairman

OVERSIGHT ON THE IMPLEMENTATION OF THE AGRICULTURAL CREDIT ACT OF 1987

With Respect to the Entire Farm Credit System

THURSDAY, JUNE 16, 1988

U.S. SENATE,
SUBCOMMITTEE ON AGRICULTURAL CREDIT OF THE
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:23 a.m., in room SR-332, Russell Senate Office Building, Hon. David L. Boren (chairman of the subcommittee) presiding.

Present or submitting a statement: Senators Boren, Melcher, Harkin, Conrad, Daschle, and Karnes.

Also present: Senator Exon.

STATEMENT OF HON. DAVID L. BOREN, A U.S. SENATOR FROM OKLAHOMA

Senator BOREN. I will call the hearing to order and we will commence. We will have our first panel come on up to the table at this time—the members of the Farm Credit Administration: Mr. Naylor, Mr. Billington, and Mr. Duncan.

Other members are expected to join us. We have had some votes on the floor this morning, so members will be coming in and out due to other meetings going on.

The purpose of today's hearing is to discern the status of the implementation of the Agricultural Credit Act of 1987 as it relates to the Farm Credit System.

We have, thus far, mixed reports about the implementation of the 1987 act. In some areas, and in some respects, it appears that it is working relatively well. In others, there appear to be some serious problems.

A number of concerns have been raised over the past couple of months. As I understand the situation in the Omaha District, the Federal Land Bank of Omaha is, and has been, since January, in violation of the Farm Credit Act, since it has not requested certification.

Despite this, the Farm Credit Administration, the entity charged with enforcing compliance with the Farm Credit Act, has not taken any steps to ensure that the Omaha District comply with the act.

There has been talk about limited certification by the Assistance Board, despite the fact that the act makes very clear that there is no such thing as limited certification.

Under the act, once certified, a System institution's stock must be brought up to no less than 75 percent of par value, and there is to be appropriate supervision of the actions of the district during this period of time, to make certain that the funds which are being extended are efficiently and effectively used.

We have heard numerous reports that the System is not restructuring loans in the manner prescribed under the act, and in some cases that have been brought to my own attention, the System, while not violating the letter of the law, has certainly violated the spirit of the law.

There is one case, for example, with which I am familiar. When it was determined that the farmer would in fact cash-flow under his proposed restructuring plan, the System decided that it needed the farmer's payment a month earlier, doubling up on payments within that particular calendar year, thereby resulting in the farmer's inability to cash-flow during the first year, so that the restructuring plan could be turned down.

This is the kind of violation of the spirit of the law which is disturbing to me, and I am sure it is disturbing to other members of the committee and to the Senate.

Finally, some concerns have been raised in regard to the situation in Jackson, where we now obviously have a liquidation and a receivership in process.

At a time when thousands of farmers are struggling to save their farms, it is inconceivable to me that we should be paying as much as $240,000 for the services of a receiver, and I would hope that we would certainly try to reduce that cost and negotiate to reduce that cost.

The FDIC operates with far lower fees. Of course we are dealing essentially with Government employees in that situation, and I would hope we would find a way to reduce these costs.

In addition, given the apparent problems that have existed in the Jackson Federal Land Bank for a long time, it is hard to understand why these abuses have been allowed to go on for as long as they appear to have occurred.

I have heard all sorts of reports, and we want to go into those today, about the use of funds to buy expensive antiques, oriental rugs, and works of art, at a time when we had farmers going bankrupt in record numbers.

And even on top of that, there has been an inability to obtain an adequate inventory in the banks as to the value of these assets that have been acquired and what has happened to them. There have been reports of abuses of automobiles, abuses of credit cards, and inadequate auditing procedures.

There is a long laundry list of things that we have received reports about, that, at this time, need to be examined and verified, so if this kind of thing went on, we want to make sure it does not go on any place else.

It would be my hope, and my belief, that it would be an exceptional situation if it did go on, but we owe it to the farmers of this country, and to the members of these institutions which are, after all, chartered and sponsored, and now, given assistance by the Federal Government, to make sure that these funds are not being wasted, that these institutions are not being operated in an ineffi-

cient way, at a time in which so many farmers are literally on the edge.

Now, many farmers in several parts of the country are struggling also with the drought conditions, as well as the already depressed agricultural markets, to try to make it.

So I am hopeful that we can obtain some answers to these questions today. I welcome all of our witnesses. I appreciate very much their willingness to be with us today and to respond to our questions.

The members of this subcommittee worked very hard in crafting the legislation over several weeks and months in many long hours of meetings, and obviously we have a very deep interest in the manner in which the act is being implemented, and in which the spirit of the law is being followed.

I would like to ask if any of my colleagues have opening comments they would like to make. Senator Daschle.

STATEMENT OF HON. THOMAS A. DASCHLE, A U.S. SENATOR FROM SOUTH DAKOTA

Senator DASCHLE. Well, Mr. Chairman, I would just associate myself completely with your remarks. We put a tremendous amount of effort into this bill. We had every expectation that as a result of this legislation we would begin to see some real results, and a new-born confidence in the Farm Credit System.

I think, to a certain extent, that has happened, but certainly by our presence here, and the fact that this hearing is being held, I think there is continued interest.

I think there needs to be continued oversight, and I certainly think there needs to continue to be a confidence-building with regard to the System and how well it is working.

I have some grave concerns about the Omaha District. Frankly, I am not satisfied that we have done all that we can there. I really do question whether or not certification should not have been requested, and ultimately approved a long time ago.

But that is certainly the purpose of this hearing, and I hope we can get some answers, and I appreciate the chairman taking the initiative to hold the hearing.

Senator BOREN. Thank you very much. Senator Conrad.

STATEMENT OF HON. KENT CONRAD, A U.S. SENATOR FROM NORTH DAKOTA

Senator CONRAD. Thank you, Mr. Chairman. I, too, feel that we made an enormous investment in this effort last year, and clearly there has been some positive results from that. But, I must say I am also hearing, at every community forum I hold in my State, and in dozens and literally hundreds, now, of phone calls received in my offices, and by me personally, that something is going wrong with the implementation of the law.

I really question whether the intent of Congress is being followed. The intent of Congress I think was abundantly clear, that restructuring be given every opportunity to work with people who could cash-flow their operations, and who had acted in good faith.

Frankly, I do not find that happening in instance after instance that is being shared with me and my staff. We have had people who have gone in in good faith, and worked out restructuring deals.

I remember, very clearly, meeting with a young man who had made an offer, the offer was accepted on the basis of a 5 percent downpayment. They went in to close the deal. They told him now they required a 10 percent downpayment.

In other words, they doubled the downpayment from the time they entered into the initial deal and the time they were to sign the papers.

I could cite instance after instance where there appeared to be an attitude of preventing someone from being able to restructure, rather than working with them to allow the restructure.

I had a desperation call yesterday from a State legislator in my State about a neighbor who is being foreclosed on on Tuesday. There has been no serious attempt by the Farm Credit System to work with that person on a restructuring plan, although that farmer proposed a plan that, according to the State legislator, cash-flowed, and made good business sense.

There is a news report in my State that got broad coverage, that only 10 to 15 percent of those who are in distress are being restructured.

Mr. Chairman, if that is the result of the hundreds of hours we put into that bill, I think it would be an absolute failure, and I, for one, would support an effort to go back and reduce, or eliminate, the bailout money of the Farm Credit System.

If there is not going to be a very serious attempt to meet the intent of Congress, I, for one, am not eager to be part of a bailout of the Farm Credit System. That was not the reason we entered into the arrangements we did.

And so, Mr. Chairman, I am going to be very interested to hear the testimony and the answers to questions this morning that we get from these gentlemen, because I think there are an awful lot of people out across the country who need to be convinced that the intent of Congress is being pursued.

Thank you, Mr. Chairman.

Senator BOREN. Thank you very much, Senator Conrad.

We will receive for the record Senator Harkin's prepared statement.

[The prepared statement of Senator Harkin follows:]

STATEMENT OF SENATOR TOM HARKIN

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
SUBCOMMITTEE ON AGRICULTURAL CREDIT

OVERSIGHT HEARING ON IMPLEMENTATION OF THE AGRICULTURAL CREDIT ACT OF 1987 WITH RESPECT TO THE FARM CREDIT SYSTEM

THURSDAY, JUNE 16, 1988

Mr. Chairman, I look forward to today's hearing regarding the Farm Credit System, the second in the series of oversight hearings to be held before this subcommittee regarding implementation of the Agricultural Credit Act of 1987. That Act, signed into law on January 6 of this year, was carefully written to rehabilitate and restore stability to the institutions of the Farm Credit System. The Act provides for recapitalizing and restructuring FCS institutions, establishes expanded rights for FCS borrowers and reduces the risks to investors in FCS obligations. To assist distressed FCS institutions, the Act establishes a Farm Credit System Assistance Board and a Farm Credit System Financial Assistance Corporation and provides up to $4 billion in federal financial assistance, as well as nonfinancial assistance, to return FCS institutions to a sound financial condition.

As I earlier noted in connection with the subcommittee's hearing held in May, the way in which the provisions of the Act are implemented, including the timeliness of actions, is critical to the ultimate effectiveness of the Act in addressing the problems we face in ensuring adequate and stable sources of credit on fair and reasonable terms to farm families and rural communities. We are still in the relatively early stages of implementing the provisions of the Act dealing with the Farm Credit System, and there remain a multitude of problems to be confronted and uncertainties to be settled in that process.

I do believe that much progress has been made within the Farm Credit System toward implementing the provisions of the Act. For example, I wish to thank the management of the Omaha Farm Credit District, which serves my state, for working closely with my staff and me to resolve problems. They have faced a very difficult task and I commend their hard work and efforts. Under the leadership of President and Chief Executive Officer James Kirk, the Omaha District has cut operating costs, has attracted new business and has done better than any other district in the country in giving effect to the borrowers' rights provisions of the Act.

In view of this progress, I regret that the problem regarding failure of the Omaha Land Bank to request certification that I mentioned at the subcommittee's May hearing still exists. Section 6.4(b) of the Farm Credit Act, as amended by section 201 of the Agricultural Credit Act of 1987, provides that when the book value of an FCS institution's stock is below 75 percent of the stock's par value, "the institution shall request the Assistance Board to grant certification to issue preferred stock under section 6.27(a)." The stock of the Omaha Land Bank clearly has been impaired to below 75 percent of par value since the Agricultural Credit Act became law. Yet the Omaha Land Bank has not complied with this unequivocal requirement of the Act that it request certification.

As provided in the statutory scheme of the Act, the request for certification is the first step in the process of dealing with financially distressed FCS institutions. Under the Act, a request for certification triggers oversight and supervision by the Assistance Board of the management of the institution in order to return the institution to a sound financial condition. Further deterioration of the institution should be avoided under this oversight and supervision, thus avoiding greater bailout costs to the government and taxpayers at a later time. That is why the Act establishes a mandatory requirement that a request for certification be made when the specified conditions are met.

Once an institution is certified for assistance by the Assistance Board, a special review of the institution's loans to borrowers is made for purposes of debt restructuring and the institution becomes eligible to participate in the Demonstration Project for the sale of FCS inventory properties through reduced interest loans guaranteed by the Farmers Home Administration. This Demonstration Project provides significant opportunities for land ownership to young and beginning farmers.

I have been informed that the Omaha Land Bank and the Assistance Board are negotiating over the terms of some form of "limited certification" that would allow the Omaha Bank to participate in the Demonstration Project, but which would not necessarily entail the other consequences under the Act of requesting and receiving certification. I understand that the Omaha Bank does not believe it needs financial assistance and thus sees no need to request or be granted "full" certification. This reasoning contains two errors. First, I can see no provision in the Act that permits "limited certification" or allows it to be requested. Second, the Act does not give the Omaha Bank discretion to decline to request certification because it believes it has no need for

financial assistance. In any event, the certification process is distinct from the Assistance Board's actually providing financial assistance.

Mr. Chairman, I believe that the Farm Credit Administration, the Assistance Board and the management of the Omaha Land Bank must all take responsibility for the failure of the Omaha Bank to request certification. I hope that we will receive an explanation of this situation today and that this matter can be resolved soon so that we can move on to the real work of bringing the Omaha Bank and other FCS institutions back to financial health.

Senator BOREN. We will just proceed, now, with any opening statements, Mr. Naylor, that you and your associates might wish to make, and then turn to the members of the subcommittee for questions.

STATEMENT OF FRANK W. NAYLOR, JR., CHAIRMAN, FARM CREDIT ADMINISTRATION BOARD, McLEAN, VA

Mr. NAYLOR. Thank you, Mr. Chairman, and I would, as we have done in the past, thank you again for the opportunity to appear before your subcommittee, and commend you, particularly, and the members of your subcommittee for a very substantial and extensive amount of work which indeed did go into this legislation.

In the interest of time, Mr. Chairman, if I may, I would simply submit my prepared statement for the record in its entirety, and quickly summarize just a couple of points for you.

Senator BOREN. That will be fine. We will include the full statement in the record.

BORROWER RIGHTS

Mr. NAYLOR. First of all, with regard to all the regulatory requirements, specifically, and most notably dealing with borrower rights, and with capital adequacy, and a number of other related regulations which were a part of the act, the Agency is fully on schedule, has reported those and put them on track for final action, and has held public hearings in the last 2 weeks on the specific issues of borrower rights, and on the adequacy of the capital standards which have been established here in McLean, which were attended and participated in, heavily, both by the public and by the members of the System.

RECEIVERSHIP

With regard to the receivership in the Federal Land Bank of Jackson, for which this Agency has responsibility, the receivership has repaid $1.94 million to 758 borrowers that had eligible, frozen borrower stock.

Long-term real estate lending has been restored and is being provided by the Texas and Columbia Districts. The receivership has begun negotiating with other districts to develop a permanent service process for the three-State area, and a coordinated sale of the assets.

We have reopened all regular services to the borrowers within the district. The offices, as we reported to you at the last hearing [May 23, 1988], were reopened the Monday following the Friday closing, and by the Friday of that same week all services had been restored, including new borrower activity.

We have had extensive work in the district. We have taken possession and identified, secured, and safeguarded all the assets. We are establishing policies and procedures to implement the appropriate actions that need to be done to winddown the activities of that institution and reestablish full and complete, and viable service to the borrowers for long-term real estate within that area.

With that, Mr. Chairman, I would close my comments with my full statement in the record, and defer to my colleagues for any opening comments they may have, with your permission.

[The prepared statement of Mr. Naylor follows:]

STATEMENT OF FRANK W. NAYLOR, JR., CHAIRMAN
FARM CREDIT ADMINISTRATION BOARD

MR. CHAIRMAN, I appear before the Subcommittee today for the purpose of reporting the progress of the Farm Credit Administration (FCA) in its role as Federal financial regulator of the Farm Credit System (System). In particular, I will review the progress of implementation of the Agricultural Credit Act of 1987 (Act).

AGRICULTURAL CREDIT ACT OF 1987

Mr. Chairman, you and the members of this subcommittee have more than a full understanding of the difficulty faced by Congress in drafting legislation to refinance, restructure and regulate the Farm Credit System. The Agricultural Credit Act of 1987, the third and most comprehensive piece of legislation in as many years, I believe through your leadership and that of your colleagues, contains the tools that are necessary to correct the System's problems.

The Act, I believe, correctly leaves a great deal of the System's future and ultimate success in the hands of its borrower/stockholders.

MINIMUM PERMANENT CAPITAL STANDARDS

From the producer's perspective the 1987 Act guarantees the stock of existing borrowers and new stock issued prior to October of this year. This provides a transition period in which the individual institutions make a decision about the approach they will use to provide their capital base for the future. There is an absolute necessity for System institutions to develop what they desperately need - permanent capital at levels comparable to those of their competitors.

On February 17, 1988, the FCA issued an advance notice of proposed rulemaking in the Federal Register with regard to minimum permanent capital standards. After receiving and reviewing public comments provided during the notice period the FCA Board on April 5, 1988, approved proposed regulations concerning minimum permanent capital standards. These were transmitted to Congress for the required 30-day review and have been published for public comment. Subsequently a public hearing was held June 9, 1988, to expand the public record. The FCA professional staff is now in the process of reviewing the comments received prior to the drafting of final regulations. These final regulations will be subject to FCA Board approval. We anticipate this process will be finalized by late summer or early fall of this year.

BORROWER RIGHTS

An equally critical issue to Farm Credit System borrowers provided by the Agricultural Credit Act of 1987 are the very extensive borrower rights provisions for individual producers. Because the Congress provided for borrower rights to be effective immediately upon enactment, FCA notified System institutions that they should take all necessary actions. These provisions have been the subject of much and varying interpretation. Borrowers, including some in desperate financial condition, are asking if these provisions only apply to new loans, or also to loans already on the books. There seems to be some confusion by borrowers within the System on this issue. Questions are also coming to us from farmers who believe the right of first refusal in the Act is being denied through interpretation of the Act. So, the borrower rights provisions are being closely watched by various agricultural organizations and operators to see how the provisions will be applied. In other cases, borrowers who have managed to meet all their loan commitments are expressing dismay at the concessions being granted to certain of their neighbors in restructuring. They recognize that the costs are being borne by all interest-paying borrowers, and wonder about the negative incentives.

In developing the proposed Borrower Rights regulations the Agency followed the same procedures as the proposed minimum permanent capital standards regulations, including publication of an advance notice and consideration of responses in drafting the regulations. The proposed regulations were approved by the FCA Board on April 5, 1988, with a 30-day Congressional review and public comment including a public hearing held June 8, 1988. The professional staff has begun the process of reviewing and analyzing the record in preparing final regulations on Borrower Rights to be presented to the FCA Board for final approval.

We recognize that the borrower rights provisions created by the 1987 Act are a two-sided coin. They can have an important positive benefit for producers still facing troubled loans,

but will have significant attendant costs to the System. It is a cost which the producer/borrowers, who are also stockholders, will have to absorb.

REGULATIONS AND PROPOSED REGULATIONS

In addition, Mr. Chairman, an extensive list of other regulations and proposed regulations implementing the Agricultural Credit Act of 1987 have been approved by the FCA Board and sent out for Congressional and public review.

Proposed regulations governing the activities of the Federal Farm Credit Banks Funding Corporation were approved by the FCA Board April 5, 1988. The proposed regulation would authorize the Funding Corporation to approve the amount, maturities, rates of interest, and participations by the several banks in each issue of joint, consolidated or Systemwide obligations on behalf of the System banks. Prior to the passage of the 1987 Act, this authority was provided to System finance committees or subcommittees. The proposed regulations also authorize the Farm Credit System Financial Assistance Corporation to borrow from commercial banks with FCA approval.

Proposed regulations incorporating statutory changes concerning the appointment of a receiver or conservator by the FCA were also approved by the FCA Board on April 5. Among other things, the regulations were revised to address the retirement of protected borrower stock at par value if necessary with the assistance from the Farm Credit System Assistance Board, when an institution is liquidated.

Proposed regulations authorizing FCA to impose and collect civil money penalties, consistent with other Federal financial regulators, were adopted by the FCA Board at the April 5, 1988 meeting with a 30-day Congressional review and a public comment period.

Regulatory accounting practices (RAP) were authorized by Congress in 1986 for System institutions to defer certain interest costs and portions of their provisions for loan losses through 1988. The Agricultural Credit Act of 1987 extended that period to 1992 and the FCA has amended regulations to make this and other conforming changes.

Other regulations implementing the Agricultural Credit Act of 1987 approved by the FCA Board during its April 5, 1988 meeting include deletion of duplicative examination procedures and the withdrawal of regulations relating to the organization and operation of the Farm Credit System Capital Corporation.

At its May 3, 1988 meeting the FCA Board approved proposed regulations on the implementation of the new reorganization authorities of Farm Credit System institutions and on the election of individuals to the boards of directors of these new organizations required by the 1987 Act. The Board also adopted an interim rule on the creation of a committee required by the 1987 Act to develop a proposal for consolidation of Farm Credit System districts. An additional proposed regulation relating to Farm Credit System institutions' authority under the Act to sell credit-related insurance to borrowers was approved and forwarded to Congress for a 30-day review to be followed by a period of public comment.

FARM CREDIT SYSTEM SECURITIES

The Agricultural Credit Act of 1987 provides the needed assurance to the System's investors that Congress intends to guarantee the System's continued access to the bond markets. There is every reason to believe that there will continue to be a strong market for Farm Credit System securities. FCA shares the expectation with Congress that producers will continue to be assured a substantial pool of agricultural credit as a result of this law with the System continuing to provide funding on a national basis.

The availability of credit should be expanded even further with the creation of a secondary market for agricultural mortgages. The White House has announced the nine members of the interim board of the Federal Agricultural Mortgage Corporation (Farmer Mac) and that board is meeting today. Under the provisions of the law the Farmer Mac Board will arrange the initial offering of common stock. The interim board will continue to function until $20 million in stock has been subscribed to and fully paid for by institutions participating in the secondary market. At that point the interim board will arrange for the election and appointment of the permanent 15-member board of directors for Farmer Mac.

When you add the probable impact of the secondary market on mortgage lending to borrower rights provisions of the law, the new permanent capital standard and System restructuring alternatives, the System faces a new operating environment and a new level of competition. The

ability of the individual institutions to perform in that environment - to compete and offer services at prices producers will accept - is going to be a real challenge. So, significant competitive pressure is created through this Act to curtail costs and be competitive in terms of overhead and operating expenses.

For the producer this could be a real plus. The secondary market could provide additional market competition for sound agricultural real estate loans. It opens a new channel of credit and gives farmers and ranchers increasing confidence that they will have a reliable, competitive source of mortgage credit over the long term.

BUSINESS PRACTICES

Mr. Chairman, as you are aware, there are some things the Act does not do. It does not guarantee the survival of any particular institution within the Farm Credit System. Yet there are a series of procedures provided in the law through creation of the Farm Credit System Assistance Board, which was chartered by FCA January 21, 1988, that will ensure that System institutions will have every opportunity, under the provisions of the Act, to turn problem situations around. But if those efforts fail, the option is still available for the Assistance Board to recommend that an institution be liquidated.

This, of course, was the case in the request by the Assistance Board, and the appointment by FCA of a receiver for the Federal Land Bank of Jackson, Mississippi.

I am happy to report, Mr. Chairman, that under the provisions of the law full credit service on an interim basis for long-term real estate lending has been restored to borrowers of the former Federal Land Bank of Jackson through agreements with the Federal Land Bank of Columbia, South Carolina, and the Federal Land Bank of Texas. In addition, the receiver has mailed checks which repay $1.97 million of frozen eligible borrower stock to borrowers who had paid off their loans in the Federal Land Bank of Jackson. It is my belief, Mr. Chairman, that Congressional wisdom has prevailed in this regard. The possibility for failure and liquidation is an important incentive to the shareholders, management and directors of these institutions to undertake and use the authorities given them under this Act to regain their competitive stature.

LITIGATION

Mr. Chairman, as you have seen, the Agricultural Credit Act of 1987 has already been challenged in the Courts, specifically with respect to the one-time stock purchase to fund the Farm Credit System Financial Assistance Corporation's Trust Fund which was established as part of the mechanism to assist troubled institutions. These challenges have met with little success, however, as temporary restraining orders were denied in various Federal District Courts principally on jurisdictional grounds. Subsequent appeals in the District of Columbia Court of Appeals have also been denied, although the cases have not yet been totally resolved.

RESTRUCTURING OF THE SYSTEM

In its foresight Congress correctly decided that except for the merger of the Federal Intermediate Credit Banks and the Federal Land Banks, it would provide the mechanism and leave the decisions of how to more efficiently restructure the System in the hands of its owners - the farmer/borrowers. The merger of the Federal Intermediate Credit Bank and the Federal Land Bank in the districts into Farm Credit Banks is required to be accomplished within six months of enactment of the Act. Any further restructuring is left up to the stockholders and there are, Mr. Chairman as you know, significant potential changes that can occur. For example, the Federal Land Bank Associations (FLBAs), in the past, have been only lending agents of the Federal Land Banks. Under the 1987 Act that can be changed and FLBAs could take on the same role as Production Credit Associations (PCAs) - standing alone and acting as direct lenders obtaining their funds from the district bank the way the PCAs do. This would be a dramatic change, structurally, even if an FLBA opted to act within its own framework. Another significant opportunity for change, after the merger of the district FICB and FLB, is the possible merger of the PCAs and the FLBAs offering a full range of agricultural lending services. This would allow for improvement in the lender's scrutiny of a borrower's total operation and credit needs. But, it is all at the discretion of the member/borrowers of the System.

The Act was also specific about the restructuring of Banks for Cooperatives (BCs). It provides the option of the development of a National Bank for Cooperatives through merger and agreement with the existing Central Bank for Cooperatives and district Banks for Cooperatives. If eight or more of the BCs and the Central Bank are merged they will have unlimited territorial credit service authority throughout the country. If they do not, then partial mergers are still possible.

A special committee on BC structure of the Farm Credit System transmitted to the FCA a BC merger proposal which was approved by the FCA Board. That proposal is now before the BC stockholders and the results of the voting will determine the structure of the System's banks for cooperatives.

Mr. Chairman, as I have discussed with you in the past, I believe System restructuring will ultimately result in a very mixed set of institutions, some of them not recognizable from what has historically been the Farm Credit System. However, this does not necessarily have to have a negative impact on the System. With management efficiency it could prove, in time, to be very positive.

CONCLUSION

As I said, Mr. Chairman, the Agricultural Credit Act of 1987 contains the major provisions necessary to assist the Farm Credit System in its recovery. For this the subcommittee, through your leadership, must be commended. However, these provisions must be properly applied by all System institutions. There is no guarantee. This Act goes far to assist System institutions. The final decision about which institutions will succeed and which will fail is largely where it has always been, in the hands of the borrower/stockholders, the elected boards and the professional staffs of each institution.

That concludes my statement, Mr. Chairman. I'd be happy to try to answer any questions that you and your colleagues may have. Thank you.

END

Questions from Senator Tom Daschle
Hearing on the Implementation of the Agricultural Credit Act of 1987
Senate Agriculture Committee
June 16, 1988

FRANK NAYLOR

Restructuring and borrowers rights were an area of great concern when we wrote the law. I want to make certain that the credit review process within the Omaha District is up and running. Can you provide the Committee with an update of the Credit Review in the Omaha District?

I am certain that you are aware of the activities relating to the repayment of B stock in the Valentine/O'Neil PCA. I am afraid that this may be an indication of the type of things to come from the Omaha District. Evidentally, back in 1984 borrowers were assured that their PCA was solvent, and then a few days later they were notified that indeed that was not the case. In light of these concerns, I am asking for a status report on your investigation into the repayment of the stock and would like to encourage you to interview the 33 borrowers who were denied payments.

We have heard over and over again that the value of the stock in Omaha is below 75%. Can you please tell me, whether or not they have requested certification and if not why not?

SENATOR BOREN'S QUESTIONS ON CAPITAL ADEQUACY REQUIREMENTS

The Farm Credit Administration's (FCA) responses to Senator Boren's questions reflect the final regulations approved by the FCA Board on September 28, 1988.

1. What financial analysis has been done to justify the proposed 7 percent capital level?

The FCA arrived at the proposed 7-percent requirement after reviewing historical and projected data on System institutions, historical data on commercial banks, particularly agricultural banks, and the capital requirements of other financial regulators. After carefully gathering and analyzing all of this information and considering the comments on the proposed regulation, the FCA concluded that the proposed minimum capital standard of 7 percent is appropriate as a minimum standard for the safe and sound operation of well-managed System institutions during normal business cycles.

Specifically, the FCA estimated the levels of permanent capital that would have been required by various System institutions to survive the stress of the last 5 years and still be able to generate positive earnings in 1992 without Federal financial assistance. These studies showed that the combined FLB/FLBA system would have needed permanent capital of about 10 percent of weighted assets, with some districts needing up to 16 percent. The FICB/PCA and BC systems were estimated to need somewhat less, while many individual PCAs appeared to need substantially more.

The FCA looked at monitoring standards, developed by the System in 1982 in support of its capital preservation and other loss-sharing agreements, that set capital as a percentage of total assets at levels of about 1.5 percent for FICBs, 4 percent for FLBs, 7 percent for PCAs, and 7 percent for BCs. In 1984, the System set the capital standard for banks to be 7.5 percent of total assets. After risk-adjusting total assets and eliminating double-counting of capital in these institutions, the proposed standards, when applied to most of the direct lender banks, are within the range of the standards developed by the System.

The FCA looked at permanent capital ratios for the FLBs in those districts able to maintain positive net operating incomes during the years 1985 to 1987. After double-counted capital was eliminated, the ratios of the banks' remaining capital to risk-adjusted assets ranged from 8.5 to 11.2 percent, averaging about 9.7 percent. The FCA has concluded that very few, if any, institutions desiring to generate consistent net positive earnings throughout periods of stress could operate with much less than 8 percent risk-adjusted capital.

The FCA considered the long standing and recently eliminated statutory and regulatory debt-to-capital ratios which ranged from 10-to-1 (for PCAs) to 20-to-1 (for banks), and which are equivalent to 9.1 and 4.8 percent total capital-to-total asset ratios, respectively.

The FCA compared the 7-percent standard with the 8-percent standard proposed by other Federal regulators for commercial banks. The proposed 7-percent standard is roughly equivalent to the 8-percent standard after taking into account the inclusion of the allowance for losses (up to 1.25 percent of risk-adjusted assets) and the fact that the nonequity items that could be counted are not frequently used by agricultural commercial banks.

The FCA compared the 7-percent risk-adjusted rate with the capital ratios required by other Federal regulators, prior to the adoption at the 8-percent standard, which were not risk adjusted. The FCA computed the amount of permanent capital that would have

been required in each System bank for the years 1984 to 1987 had the 7-percent risk-adjusted standard been in effect; divided the result by total assets to derive a permanent capital-to-total asset ratio; and then compared the result with other Federal regulators' current capital to total asset standards. The FCA also compared for 1985 and 1986 the actual levels of permanent capital maintained by System banks with actual commercial bank primary and equity capital ratios for commercial and agricultural commercial banks within each System district.

2. What assumptions were made when you prepared this analysis regarding the level of assets, number of borrowers, etc.?

An analysis was made of the ability of the FCS institutions to satisfy the proposed requirement under "most likely" or "baseline" assumptions made by FCA. The results and conclusions assume the following:

The analysis was done for 11 merged FLB/FLBA/FICB units, 12 consolidated districtwide PCA units, and the 13 BC units. The institutions face the following conditions:

- -- accrual loans gradually stabilize and begin to show some recovery over the forecast horizon as land prices stabilize and begin to increase;
- -- problem loans continue to decrease over the horizon as restructuring continues;
- -- levels of acquired properties and chargeoffs continue to decrease substantially over the short term as the financial condition of borrowers improves and land and other collateral markets stabilize;
- -- allowance levels decrease sharply over the short term in line with the improving condition of the loan portfolio; and
- -- interest rates rise moderately.

The analysis also assumed that the institutions continue to operate under essentially the same operating and capital policies as currently:

- -- spreads are relatively unchanged except for institutions showing impairment at yearend 1987 which are widened slightly over the short term;
- -- operating expenses are assumed to increase at about the same or lesser rate as accrual loans. Operating expenses of the individual BC units were adjusted to allow for the prospective merger;
- -- the cost of debt forecasts take into account long-term debt currently in the institution portfolios which is scheduled to mature over the forecast horizon. In addition, they assume that the maturity of any new debt issued is short, averaging about 180 days;
- -- the institutions are assumed to continue to capitalize themselves through borrower stock purchases as a percentage of loans which is equal to the yearend 1987 ratio of par value of capital stock to loans;
- -- To make projections of permanent capital for the FCBs and PCAs, the double counted PCA ownership capital was assumed to be counted at the PCA level. The permanent capital projections for the BCs and CBC assumed the double counted ownership capital to be counted at the BCs.
- -- the risk-adjusted assets were computed according to the weights described in the proposed regulation. Projections of off-balance sheet items and guaranteed loans,

drawn from yearend 1987 information, were made for each year in the BC system.

3. How many institutions do you project will not be able to meet the 7 percent requirement in the first through fifth years of implementation of the new standards?

Based on the regulation as originally proposed on May 12, 1988, the FCA projected that most institutions would meet the 7-percent standard by yearend 1993. Of the 37 banks examined, 28 were projected to be at or above 7 percent by yearend 1993. (Of these, 8 banks for cooperatives will merge into a National Bank for Cooperatives and 22 of the FLBs and FICBs have merged to form 11 FCBs.) Six institutions were projected to attain permanent capital ratios below 7 percent but to show generally positive earnings trends. Three institutions are projected to attain permanent capital ratios below 1 percent and to show declining earnings trends over the forecast period. It should be noted, however, that the final regulation adopted by the FCA Board differs substantially from the regulation proposed in May.

Preliminary examination was also made of the ability of PCAs to achieve the required 7 percent. It was concluded that about 92 of the 132 PCAs seemed able or likely to achieve the standard. The remaining 40 PCAs were judged marginal or unlikely to meet the requirement without external assistance.

These results rest on the assumption that all double duty capital would be counted at the association level. The final regulation made changes in the method of eliminating double counting of capital between direct lender associations and their funding banks which may affect these results. Since the allocation of double counted capital is a matter of agreement between the bank and the association under the final regulations, it is not possible to make meaningful projections for individual institutions until such agreement is reached.

4. What will be the impact of the proposed capital requirements on interest rates to borrowers on a district-by-district basis?

The impact of the proposed capital requirements on interest rates cannot be determined at this time. The effect will be dependent, among other things, upon the bylaws adopted by the stockholders of each institution. However, there are a number of avenues other than increased interest rates open to Farm Credit System institutions to generate additional capital, including the issuance of additional at-risk stock, reducing operating expenses, conversion of protected stock to at-risk stock, and, for associations, downstreaming additional capital from earnings of the bank. Since these institutions have historically held capital above the required permanent capital level, and have a variety of means of meeting their capital needs, the regulations, per se, it is believed that capital standards can in most cases be met with relatively little, if any, impact on interest rates. However, there are situations where associations will have to raise interest rates: if the association has little or no retained earnings, if it chooses to convert a minimum of protected stock to at-risk stock, if it chooses to require low levels of stock purchase by borrowers, if it cannot or will not reduce its operating expenses, and if the association borrows from banks that cannot or will not retire allocated equities or distribute earnings in cash.

5. Do you believe that some interest rate increases to borrowers will be necessary in order for the System to generate new capital?

System institutions may improve their ability to meet the capital requirement by increases in their permanent capital or

decreases in risk-adjusted assets or both. The sources of permanent capital are additions to unallocated retained earnings and issuance of at-risk stock (stock issued to borrowers after third quarter 1988). The institutions must therefore change one or more of their operating policies which will increase earnings or increase at-risk stock to increase permanent capital. For example, they may lower operating expenses below the baseline projections, or require borrowers to purchase additional at-risk capital. The institutions may also meet the proposed ratio requirement by lowering the amount of risk-adjusted assets which must be capitalized at the required ratio. Hence, there are alternatives to increasing the spread between interest rates to borrowers and the cost of funds in order for System institutions to generate new capital. Depending on its individual circumstances, the use of one or more of these policy alternatives may well be sufficient to enable an institution to generate the needed capital without increasing effective interest rates to borrowers. However, institutions that reduce their borrower stock purchase requirements will have to raise their stated interest rate merely to maintain the same effective interest rate.

6. Could you explain why you believe System institutions can make a sizable contribution toward meeting the capital standard through belt-tightening, cost-cutting moves?

The effect of a range of decreases in operating expenses, with no changes made to any other accounts, was examined as part of the analysis of policy alternatives indicated in the answer to No. 5. The amount of the increase depended on the decrease in expenses. The decreases chosen for examination were comparable both to decreases recently made by System institutions and to the decreases in loan volume which they have experienced. The projected operating expense reductions were not themselves sufficient to enable the seriously deficient institutions to satisfy the permanent capital requirement at yearend 1993. The funding mismatch was the larger problem over the projected period. However, cost reduction is one of the areas where management has discretionary control, and our analysis showed that System institutions were able to improve their overall capital positions significantly, and that they are able to build capital at faster rates, due to the cumulative impact of the additions to earnings. The amount of the increase depended on the decrease in expenses. The size of the impact is slightly larger in the PCAs than either of the other two bank groups (BCs and FCBs), illustrating the relatively greater significance of operating expenses versus funding expense in the PCAs.

7. Starting in 1989, the System must begin paying between 15 and 25 basis points per year to capitalize the insurance corporation. Should not the existence of the insurance corporation decrease the capital needs of the System since it will be put in place to protect the purchasers of System bonds?

The level of minimum capital was determined by the FCA without regard to potential assistance by the Insurance Corporation. Similarly, the FDIC, FED, and OCC determines the capital requirements of commercial banks without regard to the size of the reserve in the FDIC. The actual level of reserves in the Insurance Corporation during the next 5 years would be insufficient to assist any single large institution in the System in a material way. It should also be noted that the minimum level of capital required is much lower than historic levels in the System and may be lower than the capital needed by most System institutions.

8. When will the System have to begin repayment of financial assistance and the cost of the Jackson liquidation? What do you expect those costs to be? (See following response.)

9. Will these costs add significantly to the cost of doing business?

Based on the procedures set forth in section 6.26 (a)-(d) of the Farm Credit Act of 1971, as amended by the Agricultural Credit Act of 1987, System institutions are required to repay the principal and interest on obligations issued by the Financial Assistance Corporation over a 15-year period.

The Assistance Board has estimated that it would take at least $600 million to sustain the bank for the next few years, and there was no assurance it could ever regain enough strength to repay, as the 1987 Credit Act requires. The Assistance Board estimated the cost of placing the bank in receivership to be around $300 million, and determined this to be the more cost-effective option.

We respectfully refer you to the Farm Credit System Assistance Board, which is authorized by the Act to determine if Federal financial assistance is the appropriate alternative, for the Assistance Board's estimate on the anticipated costs.

10. The System must be competitive to be viable. Is there a serious question about whether or not System institutions can be competitive and still meet the standard proposed?

The 7-percent standard imposed on Farm Credit System institutions is substantially similar to those imposed on commercial banks that are their primary competitors. The capital standard is intended to be a prudential minimum standard and designed to promote safety and soundness. While some institutions are currently struggling to undo the consequences of prior years' decisions and events, the capital standard is phased in through a series of customized interim standards that take in account the institution's starting position. Furthermore, no increases in the permanent capital ratio over the institution's June 30, 1988 ratio is required until January 1, 1990.

In addition, the final regulation establishes forbearance criteria for institutions that do not meet minimum standards based on an annual increase in an institution's permanent capital ratio, which, if met, would ensure that no enforcement action based solely on failure to meet the minimum permanent capital standards would be taken. Farm Credit institutions that cannot meet the minimum interim standards or the forbearance criteria are likely to have deeply rooted systemic problems and are not likely to remain viable--much less be able to compete for new business.

11. Do you have a projection on how many borrowers will leave the System if this standard on capital is implemented?

It is not possible to project in a meaningful way how many borrowers will leave the System as a result of the impact of the regulation. This is in view of the uncertainty over how districts will choose to allocate double-counted capital and how individual institutions will choose to respond to the new capitalization provisions of the Agricultural Credit Act of 1987. We note, however, that the 7-percent standard is in line with historical System capital levels and standards established by other regulators and that the regulation offers considerable flexibility in the phase-in period designed with marketing considerations in mind. Also, we believe that customer loyalty is a complex phenomenon that cannot be explained solely by loan terms.

12. Some have indicated that the FCA proposal on capital adequacy will have a negative impact on mergers between financially healthy and financially weak institutions. The theory is that there is no incentive for the healthy institution to take on this additional burden. Would you comment on this, especially in light of your view that the System has to streamline its operations?

There is always a reluctance on the part of a healthy institution to merge with a weak one. The capital adequacy standards are designed to provide a measurement for the minimum level of capital for a healthy institution and should have little effect, in and of itself, on the decision of a strong institution whether or not to merge. The benefit of being able to offer "one-stop" service--both long- and short-term credit--and the cost effectiveness of combining office and personnel can provide substantial economic incentives for PCAs and FLBAs to merge. These two factors will provide impetus to look beyond the next few years in determining the best structure for the future.

It seems clear from the floor debate in passage of the 1987 Act that Congress intended the merger process to be an opportunity available to System institutions. Institutions unable to meet the capital requirements may nevertheless provide other benefits to a merger partner and in any case the financial assistance and protected stock features of the 1987 Act provide a "safety net."

13. If System institutions must meet the proposed capital standards in order to be viable, and the law requires that sufficient assistance be provided to make the institution viable, is it not the case that the proposed standard will require more, not less, Federal financial assistance for the Farm Credit System?

While meeting capital standards may be some evidence of viability, the capital standard does not define viability. An institution becomes viable when it can meet all of its obligations and provide an acceptable increase in its shareholders' wealth on a regular basis. Establishing prudential capital standards is important to promote the safe and sound operation of Farm Credit institutions so as to preclude reliance on Federal assistance in the future.

The amount of capital needed by an institution to be viable depends on the kinds of risks the institution chooses to expose itself to, the needs of its borrowers, the quality of its management, and other factors. Merely meeting the 7-percent standard is no guarantee of viability or even capital adequacy. In our judgment, few Farm Credit institutions will be able to compete effectively in the risk-prone and increasingly competitive agricultural credit market with capital of only 7 percent.

The fact that an institution does not meet the 7-percent standard does not mean that stock is impaired or that the institution is automatically entitled to Federal assistance. Financial assistance is dispensed in the discretion of the Assistance Board when it determines that with such assistance the institution can return to viability.

If the question is premised on the belief that institutions must meet the standard so that stock retirements and earnings distributions can continue in order to remain viable, we note that interim standards during the phase-in period are reasonably set by reference to the permanent capital ratio on June 30, 1988, and that no increase is required until January 1, 1990. These interim standards are considerably more attainable and should not constitute an insurmountable marketing hurdle for most institutions.

14. FCA's proposed regulations require a linear approach (i.e., 20 percent per year) toward building capital. Is it reasonable to expect those institutions that have been hit the hardest financially to accumulate these large amounts of capital in the next 1 to 3 years?

The overall intent of the regulation was to make it as reasonable as possible to meet the standard within the statutorily mandated 5-year period. The final regulation delays for 1 year the requirements to increase capital. All protected stock that is

converted to at-risk stock can be counted to meet the capital requirements. In addition, to avoid the adverse impact of certain extraordinary expenses in the first quarter of 1988, the final regulation uses the institution's permanent capital ratio as of June 30, 1988, as the beginning capital ratio by reference to which interim standards are derived.

In view of these changes, the FCA did not deem back-loading to be either needed or wise. If the phase-in were to be back-loaded so that most of the capital must be accumulated during the last 2 years of the phase-in, the requirements would no longer match the rates at which even healthy institutions could be expected to build capital. Institutions could also be lulled into a false sense of security and could distribute earnings unwisely, making a back-loaded phase-in more difficult to meet than a straight-line phase-in.

15. What actions will be taken by the FCA against institutions which fail to meet the interim goals?

We have assured the Farm Credit institutions that the FCA will take no enforcement action if the institution is making a good faith effort to meet the standard and is making satisfactory progress toward that end. Indeed, a safe harbor provision setting forth specific criteria was added to the regulation to provide assurance of this intent. Institutions that do not meet the forbearance criterion will be evaluated on an individual basis during the examination process and a determination of the appropriate action will be made following that examination.

16. What impact will FCA's regulations have on the availability of credit? Some have said that the requirement to build capital so quickly serves as a disincentive for the System to make new loans. What is your opinion?

Farm Credit institutions have a statutory obligation to serve the needs of creditworthy eligible borrowers in their territories, and Congress has provided a mechanism that ensures that funds are available for that purpose. The regulations should not have an adverse impact on the availability of credit from the Farm Credit institutions, except perhaps those that are experiencing severe financial stress and require the minimum in membership capital. Generating sound new loan volume would, in fact, increase an institution's capital through stock purchases made in connection with the loan and through increased earnings. The amount of capital so generated would be dependent upon the ratio of membership capital to loan volume as well as the rate of interest charged on loans. In addition, restrictions on Farm credit institutions investing their liquid funds purely for profit should operate to prevent the institutions from diverting funds from their primary lending function to nonloan income-generating investment.

17. In your opinion, should System institutions stop making new loans, or considerably tighten their credit standards as a way to achieving the minimum capital levels?

Credit standards have been tightened in many institutions, not in response to new capital standards but to the substantial losses incurred partly as a result of previous credit standards. This occurrence should be compared with the unrestricted lending activities of some Farm Credit institutions in the late 70's and early 80's. We believe the capital requirements will encourage more prudent lending inasmuch as the capital will have to be accumulated at the lending level and management will be charged with preserving that capital.

The capital base of an institution provides a limit or basis from which a well-managed portfolio should be built. It should provide a general limit as to size and quality. Although other

options are available to an institution, as indicated in our response to question number 5, one way to meet capital requirements is to reduce assets.

We believe that, over time, institutions will build their capital bases to accommodate the loan volume in their territories. In addition, the use of the Federal Agricultural Mortgage Corporation (FAMC) facilities will provide institutions with an ability to originate and service mortgage loans that require less capital support, thereby adding another element of flexibility to institution operations.

18. Will the proposed standard serve as a disincentive for the System to participate in capitalizing the secondary market?

Investments in the Federal Agricultural Mortgage Corporation (FAMC) should be based on each institution's analysis of the cost and probable return over time. The desire to use FAMC services will be an overriding factor in the decision to buy stock. Investments in FAMC securities by Farm Credit institutions require capitalization at the same rate as investments in all other Farm Credit institutions. Access to FAMC allows institutions to originate and service loans, thereby creating an earnings stream, without the requirement to book the assets. Depending on the business strategy and management's control of the risk involved, the resulting FAMC guaranteed loan activity should result in less risk to the institution and consequently be less capital-intensive.

19. Are there significant differences in the components of capital between FCA's proposed 7 percent level and what has been proposed for commercial banks? (See following response.)

20. It has been argued that only "core" capital is a valid comparison between the System's capital standards and those for commercial banks. What is your opinion? (See following response.)

21. Should loan loss reserves be counted as capital? If not, why? Could the FCA net loan loss reserves out in the determination of risk assets? Do rural banks count loan loss reserves as capital? If loan loss reserves were counted as capital, what would the System's capital level be?

The 1987 Act appropriately does not allow loan loss reserves to be counted as permanent capital. Rather, in accordance with GAAP, the FCA's final regulation considers "reserves" as contra or valuation accounts intended primarily to state as accurately as possible the value of loan assets. Although "available" in a bookkeeping sense, these "reserves" are not paid-in capital available generally to protect the shareholders and debtholders of the enterprise.

The proposed inter-agency guidelines for commercial banks would allow loan loss reserves to be counted as capital up to 1.25 percent of the 8-percent total. In Farm Credit institutions, only those statutorily mandated loan loss reserves in excess of the GAAP requirement may be counted.

Commercial banks may include subordinated notes and hybrid (debt/ equity) capital instruments to meet the 8-percent minimum. The agricultural commercial banks, with which Farm Credit institutions compete, with very few exceptions, do not use these notes and instruments to any large degree. For all practical purposes, and except for loan loss reserves, both sets of institutions will have to meet their capital standards with common equity.

The Federal Farm Credit Banks Funding Corporation reported on August 15, 1988, that the Farm Credit System, in aggregate, had allocated $2,567,474,000 as an allowance for loan losses at June 30, 1988. This allowance amounted to approximately 3.9 percent of the total assets of the System on that date. The ratio would be larger if riskadjusted assets (not reported) were used. Combined capital, including protected stock, was $5,238,990,000 (or

8 percent) at June 30, 1988. Combined capital and allowance for loan losses was about 11.9 percent, in aggregate, on June 30, 1988.

22. Could you give the Committee assurances that FCA and the Assistance Board are working together to ensure that joint and several liability is not triggered with regard to Jackson?

Let me assure you that the FCA and the Assistance board are working together as envisioned by the 1987 Act. However, the matter of whether or not the Assistance Board would provide assistance to the Federal Land Bank of Jackson in Receivership to meet its debt obligations is entirely within the purview of the Assistance Board, and we respectfully refer you to Dr. Thor and the Assistance Board for their response to your question.

Questions from Senator Tom Daschle
Senate Agriculture Committee Hearing
June 16, 1988

Question: Restructuring and borrowers rights were an area of great concern when we wrote the law. I want to make certain that the credit review process within the Omaha District is up and running. Can you provide the Committee with an update of the Credit Review in the Omaha District?

Answer: The borrower rights section of the Agricultural Credit Act of 1987 requires Farm Credit institutions to establish within 60 days of enactment policies to govern the restructuring of distressed loans and to provide credit review committees to consider borrower appeals of credit denials by the lender. Institutions in the Omaha and other districts are also required by the Act to report semiannually to the FCA on the results of their review of distressed loans of the lender and the financial effect of loan restructurings and liquidations on the lender. The FCA is examining Farm Credit institutions for their compliance with the statute, including the borrower rights provisions.

Question: I am certain that you are aware of the activities relating to the repayment of B stock in the Valentine and O'Neill PCAs. I am afraid that this may be an indication of the type of things to come from the Omaha District. Evidently, back in 1984 borrowers were assured that their PCA was solvent, and then a few days later they were notified that indeed it was not the case. In light of these concerns, I am asking for a status report on your investigation into the repayment of the stock and would like to encourage you to interview the 33 borrowers who were denied payments.

Answer: (The FCA subsequently replied that it had completed a special examination regarding the retirement of eligible borrower stock in the Valentine and O'Neill PCAs in liquidation. Based on that examination, the FCA found that borrower stock in the two PCAs in liquidation was appropriately retired at par value. In the cases where this stock was included in the borrower's indebtedness to the PCA as a part of a loan settlement agreement, the stock had been retired at par value against the indebtedness of the borrower. The FCA examination disclosed no exceptions in the PCAs' accounting for the terms of each loan settlement agreement compared to that of the borrowers.)

Question: We have heard over and over again that the value of the stock in Omaha is below 75 percent. Can you please tell me, whether or not they have requested certification and if not, why not?

Answer: The 1987 Act provides for System institutions with impaired stock to submit their requests for certification and financial assistance to the Farm Credit System Assistance Board. We respectfully refer you to the Assistance Board for the most current status report on any request from the Omaha Farm Credit District and the Assistance Board's actions to date.

Senator BOREN. Thank you very much.

Mr. Duncan, any opening comments?

STATEMENT OF MARVIN R. DUNCAN, MEMBER, FARM CREDIT ADMINISTRATION BOARD, McLEAN, VA

Mr. DUNCAN. Mr. Chairman, I have very brief opening comments, and would ask that the balance of my testimony be inserted into the record.

Senator BOREN. We will do so.

Mr. DUNCAN. I, too, am pleased for the opportunity to report on the progress that the Farm Credit Administration has been making in carrying out the provisions of the Farm Credit Act of 1971, as amended.

And in carrying out these responsibilities, we recognize that it is our responsibility, and our objective, to help ensure that creditworthy American farmers, ranchers, and their cooperatives, have a permanent source of adequate and constructive credit and related services, and that they are provided with fair and equitable treatment under the law.

A further objective of the Board is to help to ensure that these institutions are operated in a safe, sound, and business-like manner, so that they will rebuild and maintain their financial stability, enabling them to serve future generations of farmer borrowers.

This objective is pursued through the promulgation of regulations to implement the letter and the intent of the law through our examination function and through the exercise of enforcement actions where necessary.

It is also achieved by helping to assure that sufficient information is available to directors of system institutions, to assist them in establishing policies and giving direction to their banks and associations, and that information is provided to borrower stockholders as well, so that they may make informed decisions about the institutions that they own and control.

With that, Mr. Chairman, I stand ready to respond to questions.

[The prepared statement of Mr. Duncan follows:]

STATEMENT OF MARVIN R. DUNCAN, MEMBER
FARM CREDIT ADMINISTRATION BOARD

Mr. Chairman, I am pleased to have this opportunity of reporting on the progress that has been made by the Farm Credit Administration Board in carrying out the provisions of the Farm Credit Act of 1971, as amended.

As you know, the board approves rules and regulations for the implementation of the statute and provides for the examination of the condition of, and general regulation of the performance of the powers, functions, and duties vested in each institution of the Farm Credit System.

In carrying out these responsibilities, it is an objective of the board to help ensure that credit-worthy American farmers, ranchers, and their cooperatives have a permanent source of adequate and constructive credit and related services and that they are provided with fair and equitable treatment under the law. A further objective of the board is to help ensure that these institutions are operated in a safe, sound, and businesslike manner so they will rebuild and maintain their financial stability, enabling them to serve future generations of borrowers. This objective is pursued through the promulgation of regulations to implement the letter and intent of the law, through the examination function, and through the exercise of enforcement actions when necessary. It is also achieved by helping ensure that sufficient information is available to directors of system institutions to assist them in establishing policies and giving direction to their banks and associations and is provided to borrower/stockholders so they may make informed decisions about the institutions they own and control.

The following actions by the board were taken to implement the statute.

Regulatory Accounting Practices -- The board issued regulations by which system institutions could use Regulatory Acounting Practices. The use of these practices permits institutions to defer and capitalize certain expenses. It must be recognized, however, that while such practices may help in the short-term, they have often resulted in an increase in the pace of financial deterioration and have implications over the longer-term that could cause a burden that will have to be borne by future borrowers.

Stock Reduction -- The board adopted a policy that allows the Federal Land Banks to retire a portion of a borrower's invested capital as the loan principal is repaid. All of the borrower's capital is not tied up for the life of the loan. Though this practice is of immediate benefit to borrowers, it reduces the capital levels of institutions using it.

Director Disclosure -- The board issued regulations requiring that annual reports sent to shareholders disclose, among other things, certain loans to officers and directors. This helps assure borrowers that directors and officers, their immediate families, and firms in which they have an interest are not treated differently than other borrowers.

Federal Land Bank Association Examinations -- In order to more efficiently use financial and human resources, while meeting statutory requirements, the board adopted a policy of evaluating Federal Land Bank Associations in conjunction with Federal Land Bank examinations. In this process, the banks are provided copies of the association reports of examination, thus enabling the banks to reduce duplicative review and supervisory activity.

Borrower Rights -- The board recently issued proposed regulations governing the new borrower rights provisions of the Agricultural Credit Act of 1987, covering loan restructuring and the right of first refusal of a prior owner to repurchase or lease property acquired through foreclosure or voluntary conveyance. A public hearing on these proposed regulations was held June 8, 1988. When distressed loans are restructured in a businesslike manner and can be returned to accruing status, the result is income for the institution and an opportunity for a troubled borrower to return to financial stability.

Capital Standards -- The board has also proposed regulations dealing with capital standards for Farm Credit System institutions. A public hearing on these proposed regulations was held June 9, 1988. It is imperative that system institutions are properly capitalized with risk capital to ensure their ongoing stability and their capacity to provide constructive credit on a continuing basis.

Examinations -- During 1987, the Farm Credit Administration completed or initiated examinations of all system institutions.

Supervision and Enforcement -- The Farm Credit Administration has nine agreements and 13 cease and desist orders in effect to protect the safety and soundness of system institutions. At the beginning of the year, $35.7 billion of the system's $62.2 billion in assets were under some type of supervisory action.

Uniform Call Reports -- Starting with the quarter that ended March 31, 1988, the Farm Credit Administration implemented new, more meaningful, and more straightforward uniform call reports to ensure accurate financial reporting by system institutions to their regulator.

Though it has among its goals the provision of continuing credit service and fair and equitable treatment of borrowers, the Farm Credit Administration is a Federal regulator of financial institutions. Its relationship with those institutions is not unlike that of the Comptroller of the Currency to national banks or other Federal financial regulators to the institutions under their jurisdictions. As such, the Farm Credit Administration cannot directly involve itself in the day-to-day business operations of the borrower-owned credit cooperatives it regulates and examines. It does, however, assist the boards of directors of these institutions by pointing out weaknesses in operations in its Reports of Examination and suggesting appropriate corrective actions. And it takes decisive actions where law or regulations are being violated or when unsafe or unsound banking practices are uncovered.

Mr. Chairman, in approving the Agricultural Credit Act of 1987, as well as previous legislation, the Congress has provided the institutions of the Farm Credit System with the tools necessary to strengthen their financial positions and meet the opportunities of the years immediately ahead. These opportunities must be successfully addressed if the institutions of the system are to remain a major factor in financing rural America. But before they can seize those opportunities, many system institutions must improve the conduct of their credit business and rebuild their financial stability. Moreover, they must again become more closely attuned to and allied with their borrowers and must solve their public and member relations problems. In short, they must return to being credit cooperatives in deed as well as in fact. That concept is not in conflict with being financially successful. Nor is it incompatible with being borrower-owned and directed.

Overall, system institutions need to pay more attention to the management of the liabilty side of their balance sheets. They need to improve and streamline their credit delivery mechanisms and the process by which they make credit decisions. In many cases, this might best be done by giving local loan officers more authority, along with appropriate accountability, to make those decisions. A seasoned loan officer with a portable computer and a telephone modem working with a farmer and his wife at their kitchen table may be a more effective way of conducting business than by having an impersonal committee working with loan applications making those decisions far removed from the farm.

Again, I appreciate this opportunity and will be pleased to respond to any questions you or members of this committee may have.

END

Senator BOREN. Thank you very much, Mr. Duncan. Mr. Billington.

STATEMENT OF JIM R. BILLINGTON, MEMBER, FARM CREDIT ADMINISTRATION BOARD, McLEAN, VA

Mr. BILLINGTON. Thank you, Mr. Chairman. I, too, appreciate the opportunity to appear before you today to discuss some of the problems that we at the Agency have been dealing with recently, and I think that it would be only appropriate that I deal with borrower rights in the beginning because I hear a lot of questions and comments about this area, and it seems to be of great interest.

BORROWER'S RIGHTS

The System has lost 370,000 loans since December 31, 1982, or more than one-third of the number that it held at its peak. Many of the loans were paid off by refinancing or were liquidated. For the first time since 1975, the greatest portion of the farm debt is again in the hands of commercial banks. These are very significant numbers with grave implications for the System's image and future opportunities.

Last year, many System institutions provided restructuring of troubled loans, and they continued to do so this year. This job is difficult and requires agonizing decisions, and costly human and legal resources. From the numbers, a correct and clear enunciation in FCA regulations concerning borrower's rights can mean a great deal to the troubled stockholders and borrowers of Farm Credit System institutions, as well as the institutions themselves.

I would like to say, at the outset, that one of the big problems that exits for System institutions in restructuring, that causes them to be the "heavy" in this process. The FLB's make first mortgage loans, and end up in a priority creditor position. This often causes them to become the initiator of restructuring and sometimes, when other creditors are involved in an unworkable situation, unless all creditors agree, the Federal land bank has no choice but to foreclose due to the provisions of the 1987 act, and in the interest of all other sound cooperative borrowers, because the law requires that if it costs less to foreclose than to restructure, then that is the option that the law gives to the Federal land bank in dealing with these borrowers.

Now, we heard a lot of comments at our hearing on borrower rights, and I would like to take just a moment to discuss these with you. Basically, our Agency, in writing the proposed regulations mirrored the law, and here are some of the comments that we received at our hearing.

The witnesses stated that they feel like there is a great lack of uniformity of application of borrower rights from district to district, and even within districts.

In many districts, restructuring policies are mirror images or rearrangements of the statute, providing no additional explanation to the borrowers of their rights, and thereby leaving borrowers and employees confused and upset.

Suggestions were that FCA should issue—now this was at our hearing—as part of its final regulations, clear directions, and even

model forms and applications to be used by System institutions in the restructuring process.

Such are not currently in the proposed regulations. A great number of problems were also related concerning the appraisal process to be used in the restructuring and in the first right-of-refusal areas.

Too many appraisals, it was contended, are being made by in-house appraisers. The suggestion was made that the proposed regulations be revamped to prohibit any individual associated with or employed by a System institution from conducting an appraisal.

Definitions, witnesses suggested, should also be included for "accredited appraiser", and "independent appraisal". The key point related by witnesses concerning appraisals was that the appraisal process must be a *credible* one.

Other witnesses claimed they still are suffering from System institutions' refusal to make documents available to them, and particularly, they are concerned about the availability of calculations used to decide whether to approve the restructuring or not.

And certainly they have asked for cost of foreclosure versus restructuring. Witnesses asked that FCA, in its final regulations, spell out the criteria to be used in determining the cost of foreclosure.

From a safety and soundness standpoint, where borrower rights are concerned, either the farmer or the bank, or the association, will end up paying all the legal costs involved in settling any litigation.

One of the objectives in writing effective regulations is to make the law and congressional intent as clear and concise as possible.

CAPITAL ADEQUACY

Another issue that Chairman Naylor discussed is capital adequacy. We had a roomful of participants at this hearing. There is great concern among the System institutions about our proposed regulations.

We have proposed capital adequacy regulations that require System institutions to reach a level of 7 percent permanent capital within the next 5 years. This requirement would be achieved by taking the difference between an institution's December 31, 1987, permanent capital ratio and 7 percent divided by 5, to determine the annual increments, 1.4 percent per year, by which the interim standard for that institution should be increased each year, with the 7 percent level ultimately being reached in 1993.

Many witnesses strongly suggested that the permanent capital standard be set at the level of 4 percent. I think this is FCA's position. I think it was the position of most of the banks that were present and testified, as well as associations, as well as directors. One suggestion we heard was that there be, during 5 years, a requirement that for the years 1988 and 1989, there be no requirement; that in 1990, an institution be required to achieve 25 percent of the standard, and that by the end of the year 1991, an institution be required to have met 60 percent of the standard and be at 100 percent of the standard at the end of 1992.

Witnesses also asked the FCA Board to reconsider a portion of the proposed regulations which would subject System institutions to FCA enforcement actions if they did not meet the interim standards. They are seeking regulatory forbearance to get their houses in order.

I think the big problem is the effect that this would have on interest rates to borrowers and the noncompetitive stance that it would put the System in again if it were to have to raise that much capital. Some banks are even below a 100 percent capital, and when they merge with the FICB's, I think in most cases that will be taken care of, but in some cases not, and it would require more than 1.4 percent annual building of capital on the outstanding loan volume in that institution, which would be a difficult standard to meet.

And in many cases I have heard that it would cost as much as a 3 percent increase in interest rates in order to achieve the standard. Now these are the System's allegations.

This is a difficult problem to deal with because System entities need to have a strong capital base. I do not think any of the participants there who testified felt like that these standards are too high, from a standpoint of what they would like to see.

In fact many of them would like to see a much higher capital base in their institutions and would probably strive to reach those if conditions are such that they can be achieved.

SYSTEM REORGANIZATION

I think that System reorganization is an item that has not been touched upon here today. I think the bank of cooperatives, and the CBC merger task force is well on its way. The vote is in the process of being taken very quickly. The merger of the Federal intermediate credit banks, and the Federal land banks is in process, and I think FCA is on target, and trying to get to a position of approving these mandated mergers.

There are many questions that PCA's and Federal land bank associations have concerning these mergers, and they have a great concern about how this is going to be accomplished, and I think that our staffs have been working very hard at FCA on this issue.

FINANCIAL ASSISTANCE PACKAGE

Again, I want to compliment Congress and this subcommittee for providing a financial assistance package for the System in the 1987 legislation. If this financial assistance is appropriately used and invested by System institutions which require it, it could be of very little cost to them in the future, for they should earn enough from the virtually interest-free money for the first 7½ years to pay it back.

CONCLUSION

We should not forget that this is a cooperative System and requires stockholder and investor support to succeed. I think that the interests of these two factions should be uppermost in the minds of all of us involved.

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We do face a severe drought. I have some grave concerns about that and how it is going to impact certain districts, and certainly the restructuring proposal.

Again, I thank you for the opportunity to appear before this subcommittee. I would be happy to address any of your questions. Thank you, sir.

[The prepared statement, with attachments, of Mr. Billington follow:]

TESTIMONY OF JIM R. BILLINGTON, MEMBER
FARM CREDIT ADMINISTRATION BOARD
BEFORE THE SENATE SUBCOMMITTEE ON AGRICULTURAL CREDIT
JUNE 16, 1988

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE. I APPRECIATE THIS OPPORTUNITY TO APPEAR BEFORE YOU TO DISCUSS THE IMPLEMENTATION OF THE AGRICULTURAL CREDIT ACT OF 1987.

TO BEGIN, I'D LIKE TO EXPRESS MY APPRECIATION TO THE CONGRESS AND THIS SUBCOMMITTEE FOR PASSING THE 1987 ACT WHICH WAS DRIVEN PRIMARILY BY FARMER/STOCKHOLDER CONCERNS AND THE INABILITY TO IMPLEMENT THE 1985 ACT. I ALSO APPRECIATE THE FACT THAT CONGRESS HAS ALLOWED THE FARM CREDIT SYSTEM TO REMAIN A COOPERATIVE AND THAT THE FARM CREDIT ADMINISTRATION'S ROLE AS AN ARMS'-LENGTH REGULATOR WAS STRENGTHENED. THIS ACT WILL ALLOW FARMER/STOCKHOLDERS TO REARRANGE THE SYSTEM TO MEET THE FUTURE CREDIT NEEDS OF RURAL AMERICA.

THE 1987 ACT DEALT WITH MANY CRITICAL ISSUES, INCLUDING BORROWERS' RIGHTS, PROVISION OF A FINANCIAL ASSISTANCE PACKAGE FOR THE SYSTEM; NEW LANGUAGE TO CURE ADMINISTRATIVE PROBLEMS IN THE FCA, AND A NEW FMHA SECTION.

THE NEW LEGISLATION GREATLY INCREASES THE RESPONSIBILITY OF THE FCA BOARD AND STAFF TO PROMULGATE CLEAR REGULATIONS IN SEVERAL AREAS UNDER TIGHT TIME CONSTRAINTS. IN IMPLEMENTING THE ACT, THE FCA BOARD HAS ACTED AS EXPEDITIOUSLY AS POSSIBLE TO FULFILL ITS RESPONSIBILITIES.

ALONG THAT LINE, I WOULD LIKE TO DISCUSS WITH YOU BRIEFLY OUR PROGRESS ON REGULATIONS IN THREE CRITICAL AREAS: BORROWERS' RIGHTS, CAPITAL ADEQUACY, AND SYSTEM REORGANIZATION (MERGERS).

BORROWERS' RIGHTS

TO TRULY COMPREHEND THE IMPORTANCE OF PROPERLY IMPLEMENTING THE BORROWERS' RIGHTS SECTION, I WOULD LIKE TO ADD THE HUMAN ELEMENT TO OUR DISCUSSION. THE SYSTEM HAS LOST 370,000 LOANS SINCE DECEMBER 31, 1982, OR MORE THAN 1/3 OF THE NUMBER IT HELD AT ITS PEAK. MANY OF THE LOANS WERE PAID OFF BY REFINANCING, OR LIQUIDATED. FOR THE FIRST TIME SINCE 1975 THE GREATEST PORTION OF FARM DEBT IS AGAIN IN THE HANDS OF COMMERCIAL BANKING. THESE ARE VERY SIGNIFICANT NUMBERS WITH GRAVE IMPLICATIONS FOR THE SYSTEM'S IMAGE AND FUTURE OPPORTUNITIES.

OF THE 660,000 OUTSTANDING LOANS REMAINING IN THE SYSTEM, 40,107 WERE IN NON-ACCRUAL STATUS AT THE END OF THE YEAR AND 31,924 WERE CLASSIFIED AS HIGH RISK. LAST YEAR, MANY SYSTEM INSTITUTIONS PROVIDED RESTRUCTURING OF TROUBLED LOANS. THIS JOB IS DIFFICULT AND REQUIRES AGONIZING DECISIONS AND COSTLY HUMAN AND LEGAL RESOURCES. FROM THE NUMBERS, A CORRECT AND CLEAR ENUNCIATION IN FCA REGULATIONS CONCERNING BORROWERS' RIGHTS CAN

MEAN A GREAT-DEAL TO THE TROUBLED STOCKHOLDER/BORROWERS OF FARM CREDIT SYSTEM INSTITUTIONS, AS WELL AS TO THE INSTITUTIONS THEMSELVES.

THE FCA BOARD HAS PROMULGATED PROPOSED REGULATIONS COVERING THIS AREA. THEY HAVE ALREADY BEEN SENT TO THE APPROPRIATE CONGRESSIONAL COMMITTEES FOR 30 DAYS OF REVIEW AND HAVE NOW BEEN PUBLISHED IN THE FEDERAL REGISTER FOR PUBLIC COMMENT.

LAST WEEK, THE BOARD HELD A PUBLIC HEARING TO SEEK ADDITIONAL INPUT CONCERNING THESE REGULATIONS, AND THE CAPITAL ADEQUACY REGULATIONS WHICH I WILL BE ADDRESSING LATER. MANY GOOD SUGGESTIONS WERE MADE FOR THE FCA BOARD'S CONSIDERATION IN DEVELOPING FINAL REGULATIONS.

WITNESSES STATED THAT ONE OF THE MAJOR PROBLEMS WHICH BORROWERS HAVE BEEN ENCOUNTERING IS LACK OF UNIFORMITY OF APPLICATION OF BORROWERS' RIGHTS FROM DISTRICT TO DISTRICT AND EVEN WITHIN DISTRICTS. IN MANY DISTRICTS RESTRUCTURING POLICIES ARE MIRROR-IMAGES OR REARRANGEMENTS OF THE STATUTE PROVIDING NO ADDITIONAL EXPLANATION TO THE BORROWERS OF THEIR RIGHTS, AND THEREBY, LEAVING BORROWERS AND EMPLOYEES CONFUSED AND UPSET.

SUGGESTIONS WERE THAT FCA SHOULD ISSUE, AS PART OF ITS FINAL REGULATIONS, CLEAR DIRECTIONS AND EVEN MODEL FORMS AND APPLICATIONS TO BE USED BY SYSTEM INSTITUTIONS IN THE RESTRUCTURING PROCESS. SUCH ARE NOT CURRENTLY IN THE PROPOSED REGULATIONS.

A GREAT NUMBER OF PROBLEMS WERE RELATED CONCERNING THE APPRAISAL PROCESS TO BE USED IN RESTRUCTURING AND IN THE FIRST RIGHT OF REFUSAL AREAS. TOO MANY APPRAISALS, IT WAS CONTENDED, ARE BEING MADE BY "IN-HOUSE" APPRAISERS. THE SUGGESTION WAS MADE THAT THE PROPOSED REGULATIONS BE RE-VAMPED TO PROHIBIT ANY INDIVIDUAL ASSOCIATED WITH OR EMPLOYED BY A SYSTEM INSTITUTION FROM CONDUCTING AN APPRAISAL. DEFINITIONS, THEY SUGGESTED, SHOULD ALSO BE INCLUDED FOR "ACCREDITED APPRAISER," AND "INDEPENDENT APPRAISAL." THE KEY POINT RELATED BY WITNESSES CONCERNING APPRAISALS WAS THAT THE APPRAISAL PROCESS MUST BE A CREDIBLE ONE. MUCH MISUNDERSTANDING STILL EXISTS ABOUT APPRAISALS WHERE NO ADDITIONAL COLLATERAL IS CALLED FOR IN RESTRUCTURING. SOME SYSTEM INSTITUTIONS WILL NOT CONSIDER OUTSIDE APPRAISALS IN THESE INSTANCES.

OTHER WITNESSES CLAIMED THEY WERE STILL SUFFERING FROM SYSTEM INSTITUTIONS' REFUSAL TO MAKE DOCUMENTS AVAILABLE TO THEM. IN PARTICULAR, THEY ARE CONCERNED THAT THE CALCULATIONS USED BY SYSTEM INSTITUTIONS IN DECIDING ON WHETHER TO APPROVE OR DISAPPROVE THEIR RESTRUCTURING PLANS ARE NOT RELEASED. COST OF FORECLOSURE VERSUS RESTRUCTURING IS ALSO AT ISSUE, AND WITNESSES ASKED THAT FCA, IN ITS FINAL REGULATIONS, SPELL OUT THE CRITERIA TO BE USED IN DETERMINING THE COST OF FORECLOSURE.

ONE BIG PROBLEM EXISTS FOR SYSTEM INSTITUTIONS IN

RESTRUCTURING THAT CAUSES THEM TO BE THE "HEAVY" IN THIS PROCESS. THE FLBs MAKE FIRST MORTGAGE LOANS AND END UP IN A PRIORITY CREDITOR POSITION. THIS OFTEN CAUSES THEM TO BECOME THE INITIATOR OF RESTRUCTURING AND SOMETIMES, WHEN OTHER CREDITORS ARE INVOLVED IN AN UNWORKABLE SITUATION, UNLESS ALL CREDITORS AGREE, THE FLB HAS NO CHOICE BUT TO FORECLOSE DUE TO PROVISIONS OF THE 1987 ACT AND IN THE INTEREST OF ALL OTHER SOUND COOPERATIVE BORROWERS.

MANY, MANY OTHER CONCERNS WERE RELATED DURING THE DAY-LONG PUBLIC HEARING. I VOTED IN FAVOR OF THESE PROPOSED REGULATIONS ON APRIL 5 IN ORDER TO GET THEM OUT FOR CONGRESSIONAL AND PUBLIC COMMENT AND TO ENABLE THE AGENCY TO MEET THE STATUTORY DEADLINES IMPOSED BY CONGRESS. AS AN FCA BOARD MEMBER, I MUST BE CAREFUL NOT TO EXPRESS AN OPINION ON THESE PROPOSED REGULATIONS PRIOR TO MY VOTING ON THEM IN THEIR FINAL FORM. IT IS MY HOPE, HOWEVER, THAT THE NUMEROUS COMMENTS WE HAVE RECEIVED FROM CONGRESS AND THE PUBLIC WILL ASSIST OUR STAFF IN MAKING REVISIONS THAT MIGHT BE CONSIDERED TO BE IN THE PUBLIC INTEREST.

FROM A SAFETY AND SOUNDNESS STANDPOINT, WHERE BORROWERS' RIGHTS ARE CONCERNED, EITHER THE FARMER OR THE BANK OR ASSOCIATION WILL END UP PAYING ALL THE LEGAL COSTS INVOLVED IN SETTLING ANY LITIGATION. ONE OF THE OBJECTIVES IN WRITING EFFECTIVE REGULATIONS IS TO MAKE THE LAW AND CONGRESSIONAL INTENT AS CLEAR AND CONCISE AS POSSIBLE.

CAPITAL ADEQUACY

CONCERNING CAPITAL ADEQUACY OF SYSTEM INSTITUTIONS, THE 1987 ACT SET UP NEW CAPITAL REQUIREMENTS AND ASSIGNED FCA THE ROLE OF DEFINING MINIMUM CAPITAL ADEQUACY STANDARDS FOR ALL SYSTEM INSTITUTIONS. IN THE PROCESS, THE ACT DIRECTED THAT THE STANDARDS WOULD BE A RATIO OF PERMANENT CAPITAL TO A RISK-WEIGHTED ASSET ANALYSIS.

THE FCA BOARD HAS APPROVED PROPOSED CAPITAL ADEQUACY REGULATIONS. THESE WERE VERY DIFFICULT FOR THE AGENCY TO PREPARE. THE PROCESS WAS HAMPERED BY RESTRICTIONS IN THE 1987 ACT WHICH PROHIBIT LOAN LOSS RESERVES AND BORROWER STOCK AND EQUITY IN PLACE UNTIL OCTOBER 6, 1988 FROM BEING ELIGIBLE FOR CONSIDERATION AS PERMANENT CAPITAL. THIS IMMEDIATELY REMOVED APPROXIMATELY 73% (BASED ON MY OWN PERSONAL CALCULATIONS AND ON DECEMBER 31, 1987 NUMBERS) OF THE CAPITAL IN THE SYSTEM FROM CONSIDERATION AS PERMANENT CAPITAL.

OUR PROPOSED CAPITAL ADEQUACY REGULATIONS REQUIRE THAT SYSTEM INSTITUTIONS REACH THE LEVEL OF 7% PERMANENT CAPITAL WITHIN THE NEXT FIVE YEARS. THIS REQUIREMENT WOULD BE ACHIEVED BY TAKING THE DIFFERENCE BETWEEN AN INSTITUTION'S DECEMBER 31, 1987 PERMANENT CAPITAL RATIO AND 7% DIVIDED BY FIVE TO DETERMINE THE ANNUAL INCREMENTS (1.4% PER YEAR) BY WHICH THE INTERIM STANDARD FOR THAT INSTITUTION SHOULD INCREASE EACH YEAR, WITH THE 7% LEVEL BEING REACHED IN 1993.

THE INTENSE INTEREST IN THESE PROPOSED REGULATIONS IS

EVIDENCED BY THE FACT THAT THE FCA BOARD HEARD TESTIMONY FROM 30 WITNESSES DURING ITS PUBLIC HEARINGS LAST WEEK. MANY OTHERS, INCLUDING MEMBERS OF CONGRESS, HAVE SENT WRITTEN COMMENTS TO THE AGENCY. WITNESSES STRONGLY SUGGESTED, IN MOST INSTANCES, THAT THE PERMANENT CAPITAL STANDARD BE SET AT THE LEVEL OF 4% AND THAT THIS PERCENTAGE BE REACHED BY A NON-LINEAR GRADUATED PHASE-IN OF THE STANDARDS. ONE SUGGESTION WAS THAT FOR THE YEARS 1988 AND 1989 THERE BE NO REQUIREMENT; THAT IN 1990 AN INSTITUTION BE REQUIRED TO ACHIEVE 25% OF THE STANDARD, AND THAT BY THE END OF YEAR 1991 AN INSTITUTION BE REQUIRED TO HAVE MET 60% OF THE STANDARD AND BE AT 100% OF THE STANDARD AT THE END OF 1992.

WITNESSES ALSO ASKED THE FCA BOARD TO RECONSIDER A PORTION OF THE PROPOSED REGULATIONS WHICH WOULD SUBJECT SYSTEM INSTITUTIONS TO FCA ENFORCEMENT ACTIONS IF THEY DID NOT MEET THE INTERIM STANDARDS. THEY ARE SEEKING REGULATORY FORBEARANCE TO GET THEIR HOUSES IN ORDER.

MUCH CONCERN WAS RELATED BY WITNESSES ABOUT THE POSSIBILITY OF THE PROPOSED REGULATIONS CAUSING SYSTEM INSTITUTIONS TO BE FACED WITH RAISING INTEREST RATES BEYOND COMPETITIVE LEVELS IN ORDER TO BUILD CAPITAL. MANY FEDERAL LAND BANKS WHICH WILL BE MERGED WITH FEDERAL INTERMEDIATE CREDIT BANKS INTO NEW FARM CREDIT BANKS ON JULY 6 WILL HAVE ZERO OR LESS CAPITAL TO BE UTILIZED FOR CAPITAL ADEQUACY PURPOSES. CAPITAL CAN ONLY BE RAISED THROUGH EARNINGS OR BY ISSUANCE OF AT-RISK STOCK. SINCE EARNINGS RESULT FROM GROSS INCOME LESS EXPENSES, SYSTEM ENTITIES MUST EITHER INCREASE INTEREST RATES OR DECREASE EXPENSES, OR BOTH. TO INCREASE EARNINGS IN POORLY CAPITALIZED DISTRICTS, REPRESENTATIVES OF THE SYSTEM TESTIFIED THAT BORROWER LOAN RATES COULD INCREASE WELL OVER 3%. IF THIS HAPPENS, BORROWER FLIGHT COULD INCREASE EVEN MORE AND THESE ENTITIES COULD REQUIRE MORE GOVERNMENT ASSISTANCE THAN THEY WOULD OTHERWISE.

I KNOW FROM EXPERIENCE THAT CAPITAL SHOULD NEVER BE CONSIDERED AS A SUBSTITUTE FOR GOOD MANAGEMENT. IT IS ONLY A BRIDGE TO BE USED TO REDUCE RISK WHEN FINANCIAL INSTITUTIONS FACE CHANGES.

IN THE FINAL ANALYSIS, AT WHATEVER LEVEL THE CAPITAL ADEQUACY STANDARD IS SET IN THE FINAL REGULATIONS, IT WILL CREATE SEVERE PROBLEMS FOR CERTAIN SYSTEM INSTITUTIONS AND BORROWERS. IF PLACED TOO HIGH, THE INSTITUTION COULD BE FORCED INTO: (1) AS RELATED BEFORE, BECOMING NON-COMPETITIVE, (2) REDUCING VOLUME TO FIT AVAILABLE CAPITAL, ENCOURAGING LESS LENDING, SELLING OFF LOANS TO THIRD PARTIES, ENCOURAGING THE SYSTEM TO BECOME A SERVICE ORGANIZATION INSTEAD OF A COOPERATIVE LENDING INSTITUTION, (3) MERGING WITH STRONGER BANKS, (4) REDUCING OVERHEAD EXPENSES, (5) INSISTING ON ADDITIONAL STOCKHOLDER EQUITY, (6) RAISING INTEREST MARGINS, OR (7) ACQUIRING CAPITAL FROM THE FINANCIAL ASSISTANCE BOARD. THESE OPTIONS EACH HAVE THEIR OWN INDIVIDUAL PROS AND CONS.

THE PROBLEM WITH OPTION 2 IS THAT IT COULD FORCE SYSTEM

INSTITUTIONS INTO VIGOROUS COLLECTION EFFORTS AND MIGHT STOP LENDING TO NEW BORROWERS. OPTION 4 IS TROUBLESOME FOR WEAK BANKS BECAUSE THEIR OVERHEAD COSTS ARE BEING INCREASED BY SERVICING PROBLEM LOANS. FCA REQUIRES SAFETY AND SOUNDNESS, SO THESE ENTITIES MUST HAVE SOPHISTICATED LOAN PROCESSES, REPORTING, AND LOAN DOCUMENTATION. THIS ALL COSTS MONEY AND THESE COSTS ARE DIFFICULT TO REDUCE. WE, AS A FEDERAL REGULATOR, HAVE NO CHOICE BUT TO ASK SYSTEM ENTITIES TO COMPLY WITH SAFE AND SOUND LOAN MAKING AND COLLECTING.

OPTION 5 PRESENTS VERY LITTLE OR NO PROBLEM IN SUFFICIENTLY CAPITALIZED, HEALTHY DISTRICTS WHICH HAVE BORROWER SUPPORT AND CONFIDENCE. BASICALLY, THEY WILL PROVIDE WHATEVER MEMBER EQUITY IS REQUIRED. IRONICALLY, THESE ENTITIES DO NOT NEED THE ADDITIONAL BORROWER CAPITAL TO MEET HIGH STANDARDS. LASTLY, CONCERNING OPTION 7, ALTHOUGH THIS CAPITAL IS EXCLUDED FROM PERMANENT CAPITAL IN THE PROPOSED REGULATIONS, IT COULD INCREASE EARNINGS IN WEAK BANKS IF APPROPRIATELY USED AND COULD COST TAXPAYERS VERY LITTLE.

AS I RELATED IN MY DISCUSSION OF BORROWERS' RIGHTS, I AM HOPEFUL THAT THE MANY COMMENTS RECEIVED FROM MEMBERS OF CONGRESS, SYSTEM INSTITUTIONS, AND THE PUBLIC WILL BE HELPFUL TO FCA STAFF IN PREPARING THE PROPOSED REGULATIONS IN FINAL FORM FOR FCA BOARD CONSIDERATION.

SYSTEM REORGANIZATION

THE FCA BOARD HAS COMPLETED ITS REVIEW OF THE BANKS FOR COOPERATIVES MERGER PROPOSAL. THIS WAS A DIFFICULT TASK TO ACCOMPLISH AND AT THE SAME TIME REMAIN FOCUSED AND NOT ALLOW FOR BIAS IN ASSURING THAT THE BC STOCKHOLDERS RECEIVE A BALLOT, PROXY STATEMENT, AND DISCLOSURE DOCUMENT WHICH CLEARLY EXPRESSES WHAT THEY ARE VOTING ON AND WHAT THE END RESULT OF THEIR VOTE MIGHT MEAN TO THEIR COOPERATIVES AND THEIR FARMERS BOTH NOW AND IN THE FUTURE.

FCA AND THE FCA BOARD ARE CURRENTLY IN THE PROCESS OF REVIEWING MERGER DOCUMENTS FROM ALL 12 DISTRICTS CONCERNING THE MANDATORY MERGER OF FLBS AND FICBS INTO FARM CREDIT BANKS. THIS MERGER TAKES PLACE AUTOMATICALLY ON JULY 6, 1988. NO STOCKHOLDER VOTE IS REQUIRED, BUT FCA REVIEWS AND APPROVES ALL THESE DOCUMENTS AND MAY REQUEST REVISIONS. THIS REQUIREMENT AND OTHERS HAVE GREATLY IMPACTED OUR STAFF. I COMMEND THEM FOR THE MANY LONG HOURS THEY HAVE WORKED, UNDER SHORT DEADLINES, TO MEET OUR COMMITMENTS.

BANK AND ASSOCIATION MERGERS PRESENT A BIG CHALLENGE INVOLVING MINIMUM CAPITAL ADEQUACY STANDARDS. THE FCA BOARD APPROVED PROPOSED REGULATIONS IN THE MERGER AREA AT OUR MAY 3 MEETING. APPROPRIATELY INFORMING STOCKHOLDERS ABOUT THE CHOICES THEY HAVE IS A MAJOR UNDERTAKING, AND COULD BE EXTREMELY COSTLY TO THE SYSTEM. THE OUTCOME COULD BE MATERIALLY ALTERED BY FCA'S CAPITAL ADEQUACY REQUIREMENTS AND THE ULTIMATE REDISTRIBUTION OF

ASSETS WITHIN THE SYSTEM. IF EVER FARMER/STOCKHOLDERS INTENDED TO BECOME INVOLVED IN THEIR COOPERATIVE FARM CREDIT SYSTEM, NOW IS THE TIME! I AM VERY CONCERNED ABOUT THEIR BEING EFFECTIVELY INFORMED CONCERNING ALL THE OPTIONS WHICH CONGRESS HAS GIVEN THEM UNDER THE ACT.

FINANCIAL ASSISTANCE PACKAGE

AGAIN, I COMPLIMENT CONGRESS AND THIS SUBCOMMITTEE FOR PROVIDING A FINANCIAL ASSISTANCE PACKAGE FOR THE SYSTEM IN THE 1987 LEGISLATION. IF THIS FINANCIAL ASSISTANCE IS APPROPRIATELY USED AND INVESTED BY SYSTEM INSTITUTIONS WHICH REQUIRE IT, IT COULD BE OF VERY LITTLE COST TO THEM IN THE FUTURE FOR THEY SHOULD EARN ENOUGH FROM THE VIRTUALLY INTEREST-FREE MONEY FOR THE FIRST 7.5 YEARS TO PAY IT BACK.

CONCLUSION

WE SHOULD NOT FORGET THAT THIS IS A COOPERATIVE SYSTEM AND REQUIRES STOCKHOLDER AND INVESTOR SUPPORT TO SUCCEED. THE INTERESTS OF THESE TWO FACTIONS SHOULD BE UPPERMOST IN THE MINDS OF THOSE OF US INVOLVED.

WE ARE FACED WITH A SEVERE DROUGHT IN MANY PARTS OF OUR PRIME AGRICULTURAL AREAS. THIS WILL IMPACT MANY WHO ALREADY STRUGGLE. WHATEVER GOODWILL THE SYSTEM NOW ENJOYS WAS BORN OUT IN ITS PAST REACTIONS TO FARMERS IN FINANCIAL NEED. MORE GOODWILL TO THOSE NEEDING HELP MAY BE VERY TIMELY AND ULTIMATELY BENEFICIAL TO THE SYSTEM, ITS STOCKHOLDERS, AND ITS INVESTORS.

AGAIN, THANK YOU FOR THE OPPORTUNITY TO APPEAR BEFORE THIS SUBCOMMITTEE. I WOULD BE HAPPY TO ADDRESS ANY OF YOUR QUESTIONS.

DAVID L. BOREN, OKLAHOMA
HOWELL HEFLIN, ALABAMA
TOM HARKIN, IOWA
KENT CONRAD, NORTH DAKOTA
WYCHE FOWLER, JR., GEORGIA
THOMAS A. DASCHLE, SOUTH DAKOTA
JOHN B. BREAUX, LOUISIANA

JESSE HELMS, NORTH CAROLINA
THAD COCHRAN, MISSISSIPPI
RUDY BOSCHWITZ, MINNESOTA
MITCH McCONNELL, KENTUCKY
CHRISTOPHER S. "KIT" BOND, MISSOURI
PETE WILSON, CALIFORNIA
DAVID K. KARNES, NEBRASKA

United States Senate

COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

July 12, 1988

Mr. Jim R. Billington
Member
Farm Credit Administration Board
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Mr. Billington:

We appreciate your testifying before the Committee on June 16, 1988. Enclosed are additional questions which are being submitted to you for written answers. We would appreciate receiving your answers to the questions by July 29, 1988 so that the hearing record may be printed as soon as possible.

Thank you for your cooperation.

Sincerely,

DAVID L. BOREN
Chairman
Subcommittee on
Agricultural Credit

Questions from Senator Tom Daschle
Hearing on the Implementation of the Agricultural Credit Act of 1987
Senate Agriculture Committee
June 16, 1988

GREG BILLINGTON

On the issue of certification, what correspondence has the FCA had with the Omaha District and do feel that they are in violation of the law?

RESPONSE TO SENATOR TOM DASCHLE:

Hearing on implementation of the Agricultural Credit Act of 1987
June 16, 1988

Question from Senator Tom Daschle

Concerning the problem in Omaha, the Assistance Board and the Omaha Federal Land Bank are in contact and the question of certification is largely in their hands.

Senator BOREN. Thank you very much.

Well, I appreciate the opening statements from all of you. I have just a few questions that I would like to ask. We will rotate questions around the table. I would like to go into the proposed regulations concerning the new capital adequacy standards.

It is my understanding that you proposed a permanent capital requirement of 7 percent of assets, which would be phased in over 5 years, as has been indicated. There has been a lot of concern expressed over this proposal.

I know that about 30 witnesses testified at the recent hearing. My greatest concern is how are the System institutions going to generate the earnings necessary to meet the requirements over the next 5 years' particularly since we are in this difficult situation in parts of the country with the drought.

I wondered if you have studied this, and do you have any data that you could provide us with respect to the impact that this might have on the interest rates of the various System institutions which will have to make some additional charges in order to meet these standards?

Mr. NAYLOR. Mr. Chairman, we listened with great interest to the witnesses that appeared before our public hearing.

The 7 percent proposed standard for minimum capital adequacy is comparable, in our view, to the similar capital adequacy standards that are currently being looked at by other financial institution regulators, and are proposed for that purpose.

It was my personal impression that as we questioned witnesses during the course of the day, the adequacy or appropriateness of that number was not as much in question as to the best procedure, or a fair procedure for moving from where they currently are to actually having that amount of capital on hand.

And whether some forbearance, as far as regulatory actions, or some phasing-in schedule for the more severely stressed institutions might not be appropriate.

And that was a very fair question which I think this Board properly needs to take into consideration. I think it is important to note, I think as Jim noted, that prior to the difficulty the System currently finds itself in, quite typically the amount of capital—indeed, the amount of capital necessary to offer competitive interest rates—was significantly higher than that that is proposed as a minimum standard in this instance.

It is also important to note that before you make the assertion that interest rates, in and of themselves, are the only source of capital to these institutions, that you very wisely provided the opportunity to these institutions as is the history of cooperatives to have at-risk stock, and other sources of capital funds that they can elect to make available as a means of providing the additional capital, not simply as a result of increased interest rates.

In answer to that aspect of your question, Mr. Chairman, it is difficult for us to evaluate what impact the capital standards might have on interest rates, without knowing whether or not the institutions, or their members, are prepared—and to what extent—to follow the traditional actions of agricultural cooperatives, of having investments by the users in their institutions in the form of new at-risk stock.

Or what can be achieved yet, which, in our view I think still is significant, in continued reduction of operating overhead, which is still a major factor in making funds available, prospectively, for capital improvements.

The long and short of it, Mr. Chairman, is that I think System witnesses raised some very valid points about the phasing-in procedure, and the need to be very concerned that we not adversely affect System borrowers and users in achieving a capital standard which in and of itself will provide the safety and soundness, and security to the owners of these institutions that they deserve and have a right to expect.

Senator BOREN. The regulations have not yet been issued. That is correct, isn't it?

Mr. NAYLOR. They have been issued for comment, Mr. Chairman.

Senator BOREN. For comment, but not the final regulations.

Mr. NAYLOR. They are not final. Under the procedures worked out with the Congress, we will issue them in final, there will be another 30-day period of review for the Congress to have an opportunity to comment, and they would become effective.

It would be our expectation that will probably be in early fall.

Senator BOREN. Am I incorrect in saying that by October 6, under the act, that the local stockholders were to approve and implement bylaws to put into effect the regulations that are issued?

Mr. NAYLOR. Mr. Chairman, I need to verify that. I think that is the point at which the stock guarantee expires in the form of new loans, and I believe that also connects with the bylaw requirements.

Mr. BILLINGTON. That relates to capital adequacy and bylaws.

Senator BOREN. Well, what I am concerned about is if the regulations are not final until fall, would we be giving the local institutions time to develop the required bylaws with stockholder approval, so that this would be in place before October 6?

Mr. NAYLOR. Mr. Chairman, the proposed final regs will certainly be on the table before that period of time, and the general thrust of what the options are is certainly well-covered under the law. It will require some very diligent work, in all fairness, to the individual institutions, however, to meet that date.

Senator BOREN. Well, I think it is very important that you try to move your final regulations up. You have another 30-day period after you issue the final regulations before they finally take effect.

Mr. NAYLOR. Yes, Mr. Chairman. Under the provisions of the 1987 act, Congress asked for two opportunities to review the regulations and those have to be provided, and we are required to document the comments received during the comment process which we are doing now.

I think, as a pragmatic matter, it will be very difficult to beat that date by much, but, certainly, the final regulations will be a public matter well before that time.

Senator BOREN. Well, if you have the final regulations out by mid-July, they would not really take effect until August 15, something like that. It seems to me you have got to really push this up as much as possible. Otherwise, the institutions are just not going to have an opportunity to act before October 6, and I think there

could be some real difficulties since the stock issued after that date will not have the same guarantee, isn't that correct?

Mr. NAYLOR. That is correct.

Senator BOREN. So we would really need to get the bylaws into effect. Now having heard the testimony, I do not think we are quarreling with the fact. We all want to see adequate, permanent capital established for the System. It is just a matter of whether or not the schedule is too ambitious for getting there in the case of certain institutions.

Will the final regulations specify some system of regulatory forbearance that would be applied, so that we are not putting these local districts under unreasonable schedules that would force them into raising interest rates?

Because, again, one of the reasons why we passed this bill was to get us out of this vicious cycle that we have been in that kept forcing the districts to raise interest rates, which forced more good borrowers out, and so on. That is really why we passed the bill. And, if the FCA were to come in and cause the same thing all over again, by pushing the capital standards on these districts too quickly, forcing them to unreasonable levels of income generation on a schedule that they simply could not meet—for all the work we have done, we could end up causing, because of administrative action, the very problem that we passed the bill to avoid.

Mr. NAYLOR. Mr. Chairman, I think the question that was raised by many of the witnesses with regard to the timeliness or the procedure for implementation of those standards, particularly for more troubled institutions was a valid one, and one which this Board will certainly, along with our staff, look at with regard to several ways that it might well be handled, if it should indeed be handled in that fashion.

And I think it is a legitimate point. It can be handled either by regulatory forbearance; it can be handled by permitting institutions faced with a very difficult situation, the more troubled institutions to have a different implementation schedule; or have additional supervisory review in the event that they are making reasoned progress.

There are several different approaches that have been proposed to us, and we will review all of those in considering our final regulation.

Senator BOREN. Let me just turn to one other subject, and then I have some more questions but I'll withhold. We will go around the table.

In the Jackson District, I made reference to rumors of serious difficulties that have been surfacing for quite some time in regard to the financial practices there, whether or not we have had luxury items purchased.

There have been rumors about oriental rugs, works of art, all of these sorts of things. There have been discussions about policies related to automobiles and credit cards, and inadequate accounting standards, and certainly what all of us would deem to be improper practices, unbusiness-like practices, opening the door to abuse and fraud.

What have you found, up to this point, in terms of the manner in which the Jackson District was being operated, and what are you doing about the situation to correct it?

Mr. NAYLOR. Mr. Chairman, you have requested, on behalf of the subcommittee, that we provide you information in this area, and I think it is very appropriate that we should do so.

We are in the process of reviewing all the operating controls within the district, and expenditures on a wide range of areas, as well as activities of various individuals within the district.

In response to your request, I have a few items that I would share with you today as observations, that need further development and examination on our part for complete results and action on our part.

Within the Jackson District, in the land bank situation, there were, to the best of our knowledge, 133 automobiles either owned or leased. At the time we assumed the receivership there were 40 new cars in process to be delivered to Jackson from the Farm Credit System Leasing Corporation and that action was stopped.

Senator BOREN. They were trying to obtain 40 more cars at the very time that they were going under?

Mr. NAYLOR. The autos were made available down to new lending officer levels. They were allowed up to a 1,000 miles a month, apparently, of personal use of the cars.

We found that there was very weak controls——

Senator BOREN. Now when you say "junior officer level," you are talking about the entry-level loan officer, the most junior loan officer was given an automobile with up to a 1,000 miles of personal use?

Mr. NAYLOR. That is the information that we have been advised of to date, Mr. Chairman. Our concern principally here, too, I think as much as anything, is the weak control from an auditing standpoint, over the personal use, and other use of the cars, although I would be quick to add that the reports indicate that there was an effort made to make proper reports to the Internal Revenue Service on the use of these automobiles. We will continue to——

Senator BOREN. When you say there was a policy of a 1,000 miles a month of personal use on these automobiles, there was not an adequate auditing practice inside the bank? We are not talking about what was reported as a benefit to the IRS, but inside the bank there was not an appropriate auditing mechanism to determine how much was used.

Mr. NAYLOR. The controls were weak, Mr. Chairman, to determine the extent of personal use and how it was reported. Yes, sir.

In the area of credit cards, there was no definitive control. Some employees had as many as eight credit cards, primarily gasoline and VISA cards.

VISA lines of credit ranged from $3 to $6,000. The bank that handled the cards reported that they had $60,000 of outstanding credit at the time the cards were collected.

The problem, again, that we face in this situation, is that our preliminary evaluation is that there were inadequate controls, again, on the use of these cards, and to properly apprise ourselves, or the bank, that it had fully accounted for the funds and expenditures that had been used.

Senator BOREN. Some of them had as many as eight credit cards?

Mr. NAYLOR. Yes, sir, gasoline and VISA-type cards.

Senator BOREN. VISA-type cards?

Mr. NAYLOR. Yes, sir.

Senator BOREN. And they could have gone out, I suppose, presumably, and charged personal items on these cards?

Mr. NAYLOR. That certainly was a possibility and properly, we are obligated to investigate that. I have no indication that there has been any verified instances of that, Mr. Chairman, to report to you today.

Senator BOREN. I suppose the danger, of course, to the bank would have been, that if they had, even if the individual intended to pay anything charged to that card, or make restitution, that the bank would be liable on that card since it was a line of credit extended to the bank rather than to the individual.

Mr. NAYLOR. That is correct, Mr. Chairman. In the area of petty cash there were a number of employees that had permanent advances ranging from $2 to $500.

There was an uncontrolled petty cash account for which no determination has been made to date on the source of documents supporting expenditures.

We will continue to proceed in our evaluation of that from a regulatory perspective.

The receivership has also identified approximately 240 accounts in which deficiency judgments have been rendered on the bank's behalf which have not been enforced by the bank, totaling a value of approximately $40 million.

Senator BOREN. They were sitting there with $40 million of deficiency judgments that they had not attempted to collect?

Mr. NAYLOR. Yes, sir.

Senator BOREN. And what was the duration? How long had they had these deficiency judgments?

Mr. NAYLOR. Some of them go back some time, and we are verifying the details on those, and determining whether or not they are still even enforceable.

Senator BOREN. When you say "some time," do you mean weeks, months, or, in some cases, even years?

Mr. NAYLOR. Well, at least months, and perhaps in a case or two beyond that, in terms of a year or more.

Senator BOREN. So there they were, sitting there, in a dire economic situation with $40 million worth of deficiency judgments they were not levying upon.

Mr. NAYLOR. Apparently, for whatever reason, they simply did not have sufficient controls to ensure that those were properly executed or fell in effect through the cracks.

We have a responsibility now, of course, to determine whether or not they are still enforceable and whether or not they can be collected.

It is a proper regulatory matter for us to pursue. You have asked on several occasions for specific information on furnishings. The records are rather limited on that, and we are in the process of trying to give you more specific information.

Senator BOREN. You know, I had heard these rumors, because they referred to it as a "palace," or some other term like that, I

understood, and we had had reports they were buying expensive antiques, oriental rugs, works of art, and so on. I have even heard that there are some nails on the wall without things hanging on them now.

Is there any master inventory of the works of art, and the antiques, and the rugs, and so on, that was ever prepared, with the value of each item listed in the bank?

Mr. NAYLOR. Mr. Chairman, we have been unable to identify any such list that would give us that information in its entirety.

It has been alleged that one former official was allowed to take his office furnishings with him as part of a termination arrangement, before moving on to another assignment, and that we have been able to develop some information indicating some of the cost of furniture which appears to have been rather substantial in a few instances.

However, we have not been able to complete a full review, and, in many cases, some of this material appears to have a book value, at the current time, of zero, and so we have a rather difficult process, to go back through records to determine if—the prudency and the amounts that were perhaps actually expended.

Senator BOREN. So there were some people—at least some banking officials, when they left they were allowed to take such things as their oriental rugs with them, in terms of their severance agreements, without an adequate record being made of what the value of that was in terms of a master inventory?

Mr. NAYLOR. Mr. Chairman, that is an allegation and we are attempting to verify specifically the value of the items which were provided, and in some cases they were shown with a book value of zero, so we will have to reestablish the records and our staff is in the process of doing that.

Senator BOREN. They were shown as a book value of zero?

Mr. NAYLOR. That is the report we received, Mr. Chairman. It would be appropriate, I suppose, to have a depreciation schedule on these items, and apparently they did so.

Senator BOREN. So if you bought an oriental rug and you depreciated it out—of course the rug dealers say that they never depreciate. In fact you hear these ads—their market value goes up they say. I think that is the right experience, that they do. The older they get, the more valuable they are, and they do not wear out very much, if they are of high quality, which I am told some of these things were.

Mr. NAYLOR. I think, Mr. Chairman, this reflects a concern that was raised in questions by this subcommittee at the last hearing with regard to managerial sensitivity and controls, and what effect that may have had on the institution.

I think in fairness, I need to indicate that we have a great deal of examination work to do, and whether or not—and how that might affect individual officials, if any, by any measure, is a long ways down the track, and we certainly will do everything we can to protect the assets on behalf of the System, and recover, wherever we can, in these areas, as it properly should be done.

Senator BOREN. Mr. Naylor, for example, I am told that there are nails in walls around that apparently had something hanging on them that are there now. Now just nails. Is that correct?

Mr. NAYLOR. We have been advised that that is the case; yes, sir. We have no way of knowing whether there was anything on them or not.

Senator BOREN. And do you have the investigative tools? Do you have access to the proper law-enforcement people, if necessary, to make a thorough investigation, to find out exactly what assets were in that building and what assets may have been disposed of or taken, so that we can, after the fact, put together some kind of inventory?

And are you, as regulator, seeking assistance from the appropriate investigative authorities?

Mr. NAYLOR. At this time, Mr. Chairman, we are using our own resources to conduct a thorough examination of the books and records as well as receipts, to determine if there is any basis for asking for any outside assistance.

If that should occur, we of course have the access to that assistance and would do so.

Senator BOREN. Well, I would urge you not to hesitate to ask, whether it is the FBI or anyone else that is appropriate, if it becomes necessary, to give you the investigative tools that you need to go in and find out exactly what has happened.

Because when we have sat here, trying to help this System, so that it can help the farmers of this country, and that is the reason we are concerned with this System, and there is the possibility that the money has been frittered away on items like this, like expensive antiques or oriental rugs that then disappear, and there was not even an accounting made, or that there has been improper use of credit cards by people that have seven or eight credit cards they may be using for personal use without adequate controls. And cars with 1,000 miles a month of free use.

I would not blame the farmers of this country for wanting to absolutely storm the place and try to take whatever they can get out of it.

I mean, it is such an outrageous thing, and I can just imagine what the reaction is going to be from these borrowers who have been struggling to meet these monthly payments, when they see this kind of situation.

I am certainly not saying that this is a usual situation, or that this is true in all the other districts of the System.

I do not think we would want to imply that.

Mr. NAYLOR. No, Mr. Chairman, I would certainly not want to imply that, and I think all the System institutions are very sensitive to the public image and the importance of maintaining their credibility with their borrowers, and I am quite sure all of them are taking steps to—if they have not already done so, and I would daresay probably most all have—to ensure proper controls.

I think you properly have charged this Agency, as has other Members and committees of Congress, that we are responsible for extending our examination into areas of this type and will do so as part of our regular examination process.

Senator BOREN. Well, I would just urge you on to do that because I think that nothing would do more to retain the confidence in the System, and to shore up that confidence than the demonstration, in this situation, if there have been abuses, that they will be absolute-

ly and thoroughly investigated. If anyone has been guilty of wrongdoing, that they will be forced to make restitution or even go to jail, if that is merited. I think that we do not know that at this point by any means.

I would just urge you to leave no stone unturned. I think the greatest favor you and the members of the Farm Credit Administration could do for the System is to very vigorously pursue this.

If there has been wrongdoing in this case, I think dealing with it very clearly and forcefully will have a very positive and beneficial effect throughout the System.

I think that all the reputable people in the System and the vast majority of the people in the System are reputable and honorable—and are trying to do the job at the lowest cost, and I think they would applaud you in vigorously going after any kind of improper activities that have gone on, and I would just urge you to do that.

Mr. NAYLOR. Mr. Chairman, I share that view, and I think it is important to the country that they understand, and I am sure the System does share that view, and would support fully the Agency's efforts, if we, indeed, were to determine that incidences that required further action could be verified and, indeed, needed such action.

I think the very fact it is an agricultural cooperative and owned by borrowers indicates their very diligent interest in ensuring that this type of situation is not permitted anywhere in the System, and for us to vigorously deal with it if it should occur.

Senator BOREN. Well, all of us around this table have stood with people who have gone through the trauma of losing farms that have been in the family for several generations, and the idea that this kind of greed and extravagance, and misuse of position could go on, in the midst of all that tragedy, is just beyond belief almost. We can only hope that your preliminary inquiries turn out to be not all accurate.

But, if, indeed, the kinds of things that appear to have gone on with inadequate controls, then I just think we should have absolutely no tolerance for anyone that has been involved in this kind of behavior.

Let me turn to other members and I'll come back to some other questions later.

Senator CONRAD. Would the chairman yield for just a moment on that point.

Senator BOREN. Yes, sir.

Senator CONRAD. And I am not a member of the subcommittee so I would defer to my colleague from South Dakota. But, what we have heard here is utterly outrageous.

I am sure the members of the Administration feel that way as well. Mr. Chairman, I would think it would be appropriate that we would call on the Administrator to immediately ask the FBI to be involved in a criminal investigation. What we have heard here today would suggest the potential, at least, for criminal wrongdoing.

If that is the case, then it seems to me we have an obligation to urge that law enforcement be brought in immediately.

One of the things we know in law enforcement is that the trail goes cold very quickly. By that I mean, if there are items of value that were purchased with institution funds, and have been taken for personal purposes, that is a criminal act. It seems to me law enforcement ought to be brought in immediately—the FBI—to conduct a parallel investigation to the Agency's own.

I would commend Mr. Naylor, and the other members who are conducting your own investigation and pursuing this, but I think we ought to urge, formally, Mr. Chairman, that the FBI be brought in immediately to pursue any criminal wrongdoing.

What we have heard here is so utterly outrageous it defies imagination.

Mr. NAYLOR. Senator, if I may. I appreciate your concern, but I think in fairness to everyone involved here, there is clearly a lack of appropriate auditing controls. We have a responsibility, as a regulator, to examine those and determine if there is probable cause that those might have resulted in any individual making improper use of the credit cards or other items made available to them.

I want to make it perfectly clear, though, Senator, that at this point that process is still under way, and we have no evidence of any specific wrongdoing in that district.

It appears there was poor judgment, poor controls, but it would be premature, I think, to ask for any further steps until we have completed our initial checks. If I can reassure the Senate, I would also point out that we took over full control of all assets, they are in our possession. We have full control and responsibility for the assets of that district, so there is no risk from that perspective of any further problem.

I would hate to infer, or leave the inference here, that there was widespread or rampant misconduct by anyone. Poor controls of, if you will, perks, or benefits, or methods of controlling the cost of doing business, most assuredly.

Beyond that, until we have a chance to properly assess, and make a full evaluation, I think we would do a disservice to the employees, and former employees in the area.

Senator CONRAD. I appreciate, as a former administrator myself, the sentiment. Let me just say, as a former administrator who was involved in a financial institution, in the absence of strong auditing controls and internal financial controls, my experience has been, given what I have heard here today, that if there is even the hint that somebody left with valuable property, that law enforcement ought to be called in, especially in a case where there is a lack of strong auditing controls, because the trail goes cold very quickly.

And as someone who has been involved in dozens of investigations on assets, the faster you have somebody with law enforcement ability and resources involved in the process, the greater the chance that you will bring wrongdoers to justice.

And I tell you, in terms of guaranteeing public support and confidence, I do not think an internal investigation is sufficient. It is necessary but not sufficient.

If there is any hint—and I think we have got at least a hint here today—it seems to me, Mr. Chairman, that we would be derelict not to ask the FBI to conduct an investigation simultaneously.

Mr. NAYLOR. Senator, I appreciate your counsel very much and I appreciate your concerns. However, I assure you that, as an independent regulator, you do have an arm's length review underway by people that are not a part of the System but are their regulator, and that it would be premature, I think at this point, for us to go beyond the process that we are in, until we have a firm basis to ask for any further assistance from other institutions within the executive branch.

Certainly, we have an obligation to attempt to recover, or take any other appropriate steps we can to secure assets that would impact upon the ultimate cost of this receivership to the System, and we will do so.

Senator BOREN. Senator, let me suggest this: I think it would be prudent to at least consult with the FBI at this point, to let them know some of the preliminary problems, and to ask their advice, since they are experienced in terms of making sure that no evidence is removed, and this sort of thing, if it leads to that sort of an investigation later on.

At least preliminary notification to them that you might be calling upon them with the situation. I think it would be a prudent step to take at this point, and then, if they see any problem, that since they are experienced in dealing with this, so that evidence might need to be protected, or something else, they would be able to give you advice on this point.

And you would have some communication with them, and you could work out a determination then, between the two of you, as to whether it would be appropriate, now or later, for them to come into it, depending on what the rest of your examination finds.

But I think it would be prudent to at least inform them of the preliminary nature of some of this information, and to get their advice at this point as to whether or not they feel it is appropriate for them to enter into it, or if it would be appropriate for them to wait until after you have proceeded further with your own internal regulatory investigation.

Mr. NAYLOR. Thank you, Mr. Chairman, and I am sure, as you are aware, we have a close working relationship with the Justice Department, and the Justice Department does supply our legal advice and counsel, in conjunction and support of our own internal counsel.

We will proceed to vigorously review our findings and to provide this subcommittee a full report of any incidences, and what actions are being taken by the regulator to ensure protection of assets.

Senator BOREN. Senator Daschle.

Senator DASCHLE. Mr. Chairman, I do not know if I am satisfied with that. I think that we have got to at least have a periodic report from the FCA with regard to exactly what they have done, and the FBI may have already been brought into this.

I was just given an article by the Tulsa paper, which said:

> A Tulsa consultant hired as a receiver for the Farm Credit System bank in Jackson is involved in a Federal law suit in which one of his companies is accused of racketeering.

Additionally, a man who a Federal prosecutor said is associated with the firm headed by a consultant was indicted for mail fraud by a grand jury.

And it said that records showed the books have been delivered and records and files been provided to the FBI for an investigation in the Jackson area.

So the FBI in this case has already gotten involved in one aspect of this thing. To expand it beyond that seems to me to be a very logical step.

So I would be interested, number one, in how soon FCA feels they would be finished with their investigation, in order to make a serious decision with regard to FBI involvement.

Two, whether they could provide us with regular reports, perhaps at least a periodic updating as to what they have found, and whether or not there is any additional need for us to act.

Would you respond to that, Mr. Naylor?

Mr. NAYLOR. Senator, again, I want to make it clear that what we have reported to you today are weaknesses in controls, in internal controls of resources made available to employees.

We have no information which would lead us to believe, at this point, that there has been any wrongdoing of the type you are talking about that would lead us to take any action.

However, we will, and are in the process of examining and scrutinizing—our receivership is—all the records that are pertinent, to determine if anything other than what our own enforcement requirements provide are appropriate, and we will move accordingly.

And we will, as the Chairman has asked us to do, provide information to the committee. I should point out that the article to which you referred does not bear on this issue and is not involved in this receivership situation, and the FBI is not involved.

Senator DASCHLE. It is not involved in this?

Mr. NAYLOR. No.

Senator DASCHLE. The article says that it is.

Mr. NAYLOR. No.

Senator DASCHLE. The article is in error, is that correct?

Mr. NAYLOR. As far as the receivership is concerned, yes, it is. They are not involved.

Senator DASCHLE. As far as whether the FBI is investigating this particular incident?

Mr. NAYLOR. They are not—I am not sure what—you are talking about the article, or anything involved with the receivership?

Senator DASCHLE. I am talking about whether or not the FBI has become involved in the—it states here:

> A man who is a Federal prosecutor is associated with the firm headed by the consultant and has been indicted for mail fraud by a grand jury in Tulsa. The FBI has been brought into the investigation as a result of the request by the grand jury.

Mr. NAYLOR. No, Senator they are not related to the conduct or the receivership itself.

Senator DASCHLE. Well, I am not saying that they are involved with the receivership. I am saying that in that district, FBI investigations have begun with regard to actions taken by personnel within the Jackson District.

Mr. NAYLOR. No, Senator, that is not right.

Senator BOREN. Let me clarify. The matter that is under investigation is under investigation in the grand jury, apparently, in Tulsa, which is not in the Jackson District, and it relates to some businesses, one of which is alleged that the receiver that has been appointed in Jackson had a relationship to one of the businesses that is involved.

And I think the article says a civil RICO lawsuit, and then it goes into some other matters in this "Daily Oklahoman" article. But it is unrelated. In other words, none of that goes to the Jackson District itself, or what has gone on in the Jackson District, or the things we were talking about.

Senator DASCHLE. All right.

Senator BOREN. It does go to matters affecting the receiver that has been appointed in the Jackson District.

And I have asked Mr. Naylor, and I think it would be inappropriate for us, in this forum today, to prejudge anyone in this matter.

The receiver that has been appointed has indicated that he felt he was a victim, not a participant. That is his answer to these allegations. And one of the companies he controls appears to be a defendant in a civil RICO suit.

But I have asked Mr. Naylor to supply the subcommittee with the answers to two questions. First, a question about the salary of the receiver which I have raised previously, the $240,000, and, second, the process and procedure followed in selecting the receiver, and whether or not the individual selected is appropriately qualified.[1]

I do not pass any judgment on that at this point. All of us know that allegations raised in law suits are not necessarily statements of fact. Anyone can file a law suit and make any allegation.

So I would want to be fair at this point, but it is something that I think is appropriate for the committee to ask for a full explanation of, as this matter has surfaced, and last week, when it was first brought to my attention, I did write to Mr. Naylor, and asked that the subcommittee be informed about the process and the suitability of the person selected.

Is that a fair summary, Mr. Naylor, of where that is?

Mr. NAYLOR. Yes, Mr. Chairman. Thank you. You and I have discussed this, and we will provide, as we have discussed, the appropriate information.

Senator DASCHLE. I thank the chairman for the clarification in that regard.

Senator BOREN. But it is separate and apart from the Jackson District.

Senator DASCHLE. I think the point is, that if it is separate and apart, I think it is appropriate that we handle it separately, but the point Senator Conrad made about the involvement of the FBI—I do not know whether the FCA has had any experience with regard to investigations of this kind in the past, and we want to give them every benefit of the doubt, and give them all the flexibility they may need with regard to their own investigation.

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[1] See pages 150–153.

But I think from our perspective, we have got to be concerned about the credibility of the System, and I would hope at the very least we could be given an update, some kind of a report with regard to your progress in that investigation, and what exactly has been done to clarify a lot of these outstanding questions.

They certainly have not been answered at this hearing, and I would hope that at some point in the future they would be.

I would also be interested in knowing whether FCA has queried the other districts with regard to any activities such as this.

You indicated that you were concerned, and you certainly had every reason to believe that they probably rectified it without any actions being taken, but do you have any verification of that fact?

Mr. NAYLOR. Senator, we, as part of our examination process, are beginning to move into operating areas also. By that I make the distinction between the basic safety and soundness issues regarding loans, and that area of activity which is our primary concern for the overall safety of the institution, the operating matters.

The System has been very sensitive to their expenses, and operating expenses, and the need for appropriate controls. I would say, in very straightforward fairness to them, I think they are very conscious of the need to control expenditures, to limit inappropriate, perhaps, use of—or arguably, inappropriate use of certain items like automobiles, unless they are fully and properly accounted for, and the stockholders are fully aware of what types of benefits are being provided.

I again think it is very important, Senator, in cooperating with the subcommittee, as we have discussed and I have discussed with the chairman, to make it clear for the record, that the situation here we are reporting are a series of poor controls on the part of the institution over various expenditures which represent potential for significant expenditure.

We have an obligation to pursue the internal accounting records and files, to determine if there is any indication of improper use of anything, and, if so, we would then take the appropriate action. But it would be a great disservice to the employees, even in the Jackson District, to infer that there was any widespread, or inappropriate——

Senator DASCHLE. No one is inferring that, Mr. Naylor, at all, and, you know, you have a responsibility for oversight. FCA is the oversight agency. You are the regulator. And it seems to me that your role ought to be just as much prospective as retrospective. It should not take a prairie fire like this to cause you to respond.

There are preventative measures FCA could have taken——

Mr. NAYLOR. Senator, we certainly have every intention of——

Senator DASCHLE. Let me finish, if I could, quickly, and then you can respond.

Mr. NAYLOR. Excuse me.

Senator DASCHLE. Obviously, if this has happened in Jackson, unless you can give the assurance to the subcommittee this morning, that this is not happening anywhere else, I think you owe it to the subcommittee, and to your System, to say that you can provide that confidence, that assurance. We are going through a very difficult time right now—a lot of uncertainty, a lot of lack of confi-

dence; a lot of willingness on the part of people to say the System is rotten all the way through regardless of how many bills we pass.

And it seems to me your job, in addition to oversight, is providing some new-found confidence, that we just do not have today. And so I would hope that you could provide, at least at some point in the future, the assurance to the subcommittee that you have checked through the other districts, you have talked to them, and you know that these kinds of things do not exist.

And once that happens, I think we'll get about rebuilding this process.

Mr. NAYLOR. Well, Senator, I certainly share that concern and we will do that as part of our responsibility, but I think the System itself, I think will properly indicate and can indicate that they are very sensitive to these areas and have made a lot of revisions of their own, cutting back in benefits that are being provided employees, taking steps to control expenses, and they are to be commended for that.

And I would not want to leave the impression that what may have been a very serious problem—and obviously, the problem was more serious in Jackson than anywhere else or we would not have that receivership in there—that this is a typical situation.

Senator DASCHLE. No one is saying that this is typical, and no one is implying that it is happening anywhere else. All I am saying is that we are at a very critical time, and no one is more sensitive to that than the three witnesses right now. We know you know that, but wishful thinking does not make it go away.

And the more we can honestly say to the public that we have checked this thing through, we have eliminated this kind of irresponsible spending in practice, the more we are going to get on with actually dealing with the real problems that exist.

I had hoped I could spend some time talking about certification of the Omaha District, but that proves the point. We are on this stuff simply because there is a great deal of interest in it, in trying to resolve it, but I would hope that at some point—in fact I have to preside at 11:30, Mr. Chairman. I would like to submit some questions for the record dealing directly with certification, if I could.

Senator BOREN. We will certainly receive them for the record and put the responses in the record.

Senator DASCHLE. Thank you

[See contents for the questions of Senator Daschle.]

Senator BOREN. If I see that it looks like we can go straight through and finish up by 1:30 or so, we will do so, if you want to come back in. If not, we will take a short break for lunch and go on, and try to finish around 3. So we'll sort of see how we are going.

Senator DASCHLE. OK.

Senator BOREN. And hope you can return to us. Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman. I would like to follow up on the question of the investigation.

Are there allegations, suggestions, any indication, that there has been conversion of property that belonged to the FCS that has gone into private hands?

Mr. NAYLOR. We have no specific evidence that would cause that to be a concern at this point in time.

Senator CONRAD. Are there any allegations, any suggestions, any indications, that people have taken works of art, carpets, or anything else—things that were present in those offices that are now not present in those offices?

Mr. NAYLOR. Senator, we have no way of responding to that. We have no specific information. We do not have an inventory that clearly identifies what was there, and what we need to work through, and we are in the process of doing that. Furthermore, I would point out——

Senator CONRAD. Well, the question is: Are there allegations? I mean, I have heard the chairman's suggestion that he has heard allegations of conversion. That is a criminal offense.

Have you heard—I am not asking if you have specific evidence. Frankly, I think you would have an obligation to investigate. But if there are indications that there is conversion, that is a criminal offense.

Mr. NAYLOR. Senator, we have no specific evidence of conversion in——

Senator CONRAD. That is not responsive to my question. I did not ask for specific evidence. I have asked if you had had allegations or indications of conversion.

I heard the chairman say that he has heard indications and allegations of conversion. I am not asking for specific evidence.

Senator BOREN. Let me say the "possibility" there could be conversion, because if there are things that—apparently certain property was once in the building, and we do not know if it is still there, or where it is. That opens the door to the possibility that there could have been conversion.

Mr. NAYLOR. Yes, Mr. Chairman, and I do not have any specific allegations. There are questions that are being examined, verification of records of what was in the building, is necessary to determine what, if anything, is not accounted for, and, in many instances it is possible—it has occurred in other corporations, that individuals were permitted to take with them, in the process of leaving, in lieu of other compensation, articles or items within the building, or within the institution.

That happens in many corporations. It would be premature—and again I emphasize, as I did at the outset, that what we are discussing here are weak auditing controls, weak controls which make it difficult to determine whether or not everything was properly accounted for, and that there is a long and lengthy process which has to be gone through to see if there is any basis for any allegations of any kind of misconduct which are only now beginning, and it will be some time before those are completed.

Senator CONRAD. In your investigation, does anyone in FCA have the authority to put people under oath during internal investigations?

Mr. NAYLOR. Senator, there would not be any reason to at this point because before you do that, you have to have specific evidence that there is a basis for doing so, which would involve, for example, a determination and a review of, for example, credit-card slips, whether any of those raise a question of whether a personal purchase, for example, was made, and then, was it permitted.

If the institution's controls were such that it was at least tolerated, the question of wrongdoing still may not necessarily be even able to be raised.

Senator CONRAD. Well, I do not want to belabor this any more, but I will tell you: I have been involved as an administrator in dozens of cases as a tax official, and questions of potential financial wrongdoing. My experience of over 12 years, is that if you have any hint of financial wrongdoing in an institution, getting law enforcement involved as quickly as possible is critical, not only for preserving the records that may be outside of your direct control—I understand you have taken control of those records that are there—but other financial records might be involved. Beyond that, quick law enforcement is necessary in order to secure public confidence.

Mr. Chairman, I want to turn, once again, to another question—I understand it is unrelated but I think it goes to the question of public confidence, clearly.

The headline of this newspaper story concerned a Tulsa consultant hired as the receiver for the Farm Credit System bank in Jackson. It states that he is involved in a Federal lawsuit in which one of his companies is accused of racketeering.

Is that a true statement?

Mr. NAYLOR. Senator, we are aware of a civil lawsuit involving a company named as a defendant in which the receiver has ownership.

Senator CONRAD. The story goes on to say that you acknowledge the agency was aware of his legal problems, but that you would not say whether you and the other members of the Board were aware of the lawsuit at the time Watkins was hired.

Were you aware, at the time Watkins was hired, of this lawsuit?

Mr. NAYLOR. Senator, when Mr. Watkins was specifically asked about this particular situation, he has cooperated fully, and I would ask, as the chairman did, that we provide an appropriate record for you, for the record, on this issue.

Senator CONRAD. Well, I would like an answer to the question that I have put to you. Were you aware, were the other Board members aware of this lawsuit at the time that you hired Mr. Watkins?

Mr. NAYLOR. Senator, I would respectfully request that for reasons I think you can understand, that we defer discussion of this issue at this point, but I will be pleased to provide you the information you request for the record.

Senator CONRAD. Well, Mr. Chairman, I will not pursue it further. I find it difficult to understand why that question cannot be answered, and I tell you: what I have heard here today is going to shake public confidence pretty seriously in what is a terribly important entity and institution to rural America, and that is unfortunate.

I think the quicker we move to answer these questions and clear up these questions, the better off we'll all be.

[The response of Mr. Naylor follows:]

Mr. NAYLOR. In answer to your question about the course of events, it was a couple of weeks after the FCA appointed the receiver that the agency became aware

of several matters in which Mr. Watkins was involved that had not been previously disclosed to us.

Senator BOREN. Well, let me say I agree with what Senator Conrad has said. I think we have got to move decisively.

I will say this: that on several of the items that have been brought up, Mr. Naylor has reported to me on them over the last several days, on behalf of the Board, and obviously, the fact that we know that there are inadequate controls over credit cards, inadequate controls over automobiles, perhaps some missing inventory, certainly an inadequate inventory procedure on assets in the building—works of art and this sort of thing—we do know, because the Board has uncovered it in their own investigation of the matter up to this point, in their own regulatory investigation.

So I do think it should be said that they are proceeding on this, and I think that is to be commended, that the information in essence has been brought to us and volunteered to us by the Farm Credit Administration.

I think that has to be said, to put it in its proper perspective. But having said that, let me underline what Senator Conrad has said. We obviously must do everything we possibly can to sustain confidence in this System. It is a System that has been under great economic stress because of conditions in agriculture.

We cannot afford to have additional confidence factors added to what is already an over-stressed system. We have passed legislation to get us moving in the right direction. I think in many, many parts of the country, and many districts, we are beginning to move in the right direction. There is much that still needs to be done, and the Farm Credit Administration has a very heavy burden here, and I realize a very, very difficult task to oversee as much as must be done right now. Under this new system we have put some new teeth into the regulatory process that really were not there previously. But I think it is absolutely essential that the FCA move with dispatch.

I think I understand why you are a little hesitant about saying "we'll consult with the FBI," or whatever, because you do not know and none of us want to make unproven allegations against anyone. I hope that is understood. It is wrong to make accusations about any individuals until we know, for sure, that they are well-founded. We have to be very careful with people's reputations.

On the other hand, there are some things here that look very, very bad on the surface. That is the only way to put it. They certainly are shocking, if even partially true.

I think there should not be any hesitation. Instead of casting a cloud on the System, to say we are willing to and, we are going to consult with the FBI right away to see what their appropriate role is, not that we are going to say that they are into a full-blown investigation. But I think there should be a willingness to consult with them and get their advice—to say we are into this situation and we want your advice.

They will advise you as to whether or not it is appropriate, then, at this time, for them to come into this matter, and I think that should be done. I do not think that casts any cloud over the System. I think that helps restore confidence in the System, that

the FCA is moving in a very forthright way to do this as quickly as possible.

So I would urge you to move forward on all these fronts as quickly as you possibly can. I understand that there is some time sensitivity to answering Senator Conrad's other question that was put directly to the three members of the Board, but that can be answered very shortly, and should be answered, for the record, as quickly as it is appropriate for those answers to be given because we need to know the final outcome of that as well. Again we have the confidence factor.

We have to not only have confidence that any abuses that may have occurred in the Jackson District prior to the receivership have not gone unpunished, so to speak—there has been a full accounting, and we also need to be assured that the receivership now in place is one that is moving with integrity and efficiency to handle the situation.

We need to make sure that these policies are put in place, that are a clear example to the rest of the System, that mismanagement is not going to be tolerated anywhere. I would urge you to heed the words that Senator Conrad has spoken, and I think that the greatest service this Board can do for the System right now is to move forward aggressively and with dispatch on these matters, while certainly following appropriate regard for the reputations of any individuals that might be accused without foundation. We always want that to be the case, and sometimes, that is not always carefully enough done in Washington, DC.

But we have got to get to the bottom of this. Senator Conrad is absolutely right.

Mr. NAYLOR. Thank you, Mr. Chairman, and I am very grateful for your comments. I think we would do a huge disservice to the System to reach beyond, or overreact to some clear problems in auditing controls, and internal controls which needed to be made, and require a full and complete investigation.

And also, as you so aptly did point out—that this is related only to the Jackson System, which has the most serious problems, and that we not, in any way, disparage the exemplary and the fine character of System officials throughout the country in the conduct of their business, and it would be tragic to leave an impression other than their dedication to the farmers and ranchers they serve.

Senator BOREN. I would agree with that. I think we have got to move, now that this question on the receiver has been raised. That needs to be resolved as soon as possible, and a report back to this subcommittee as to how it is been resolved, and why, and then we need to fully follow up on all the possibility for abuse that might have occurred in the Jackson District, and, you know, to be frank—if the people deserve to be exonerated they should be exonerated. If there are people that deserve to go to jail, they should go to jail, be locked up as far as I am concerned, because if anybody has acted in a greedy fashion, to take advantage of these farmers who have been going through personal tragedy, they ought to be locked up.

If I was on the jury, I would be the first person to vote to lock them up. So we ought to get to the bottom of it.

Let me ask some questions on a couple of other subjects. The receiver, as I understand it, at the Jackson land bank, is required to

apply the restructuring provisions of the recent Farm Credit Act amendments to distressed loans.

Is this policy being followed by the receiver, now, in terms of the borrower rights provisions and the restructuring provisions?

Mr. NAYLOR. Yes, Mr. Chairman. It is.

Senator BOREN. Is the policy available to the public?

Mr. NAYLOR. They would be following essentially our proposed regulations as the basis for the conduct and those are a matter of public record, now, Mr. Chairman.

Senator BOREN. Could the subcommittee be furnished with a copy of the forms and the internal instructions that are available to the public on how the receivership is being operated in this regard, as to restructuring in the Jackson District?

Mr. NAYLOR. Yes, Mr. Chairman.

Senator BOREN. We would appreciate receiving that for the record.

[The information of Mr. Naylor follows:]

J. Parameters of Loan Workouts

The justification for workout loans should be better prospects for recovery on the asset that is in the best interest of the stockholders of the institution and in compliance with applicable borrower rights regulations issued pursuant to the Agricultural Credit Act of 1987. Borrower or debtor workouts will be approved by FCA before they will be implemented if the total of the loan is in excess of the amount specified in the Agreement Between FCA and Receiver and if the workout arrangement results in a reduction of the principal or reduction of the interest.

Loan or debt renewals should not be granted unless the obligor provides the receiver with a current financial statement, including appropriate notes and explanations as the receiver may require. Prior to any workout arrangement, the receiver must review the obligor's submitted information to determine whether the workout is necessary and the terms are appropriate. If the amount is less than fully secured, the receiver should attempt to obtain as much additional collateral as needed to improve the collateral position.

The receiver should obtain advice from legal counsel as to procedures to follow in perfecting the collateral position. Decisions to extend secured loans may be detrimental to existing collateral; thus close coordination with counsel is necessary. Legal advice is necessary where consent of all obligors to a transaction is not possible.

Sixty (60) days prior to maturity date, the receiver shall inform the borrower of the loan maturity date. Usually, advances are made during this time only to honor legal commitments.

If a loan is past due, the receiver has several alternative courses of action to pursue with the borrower. After determining the quality and quantity of collateral security, the receiver may choose to renew the loan if such action is deemed to be in the best interest of the stockholders of the institution. Operations of the borrower need to be monitored carefully during the renewal period and any advances made by the receiver should be based on the borrower's operating budget and other information and data obtained by the receiver.

The receiver may choose to let the loan continue in a past due status. In those instances, the receiver should make only those advances that are in the best interest of the institution. Usually, these types of advances are necessary to preserve or protect collateral. The receiver should encourage the borrower to seek financing elsewhere.

In some cases, the receiver may choose to renegotiate the loan, or may be required to do so under provision of the 1987 Act, if the institution's position can be improved and there is a reasonable chance that the borrower will recover and repay the debt. In other cases, it may be in the stockholder's best interest to foreclose on the loan. In those cases, voluntary conveyance of collateral is preferred to litigation.

When loans are renegotiated and FCA approval is required, the receiver shall complete and forward to FCA a Loan Workout Data Sheet.

Senator BOREN. I want to turn, now, to the Omaha situation. Under section 6.4(b) of the Farm Credit Act, once the book value of stock is less than 75 percent of par value, a System institution is required to request certification for the issuance of preferred stock.

It is my understanding that one district, in particular, has been below 75 percent of par value since enactment of the Agricultural Credit Act of 1987, and until recently had not requested assistance.

Since the Farm Credit Administration is the regulator of the System, and since Congress enacted the 1985 amendments specifically to ensure that FCA had ample authority to enforce compliance, can you explain why there has not been an effort made to enforce compliance with the act in the Omaha District?

Mr. NAYLOR. Mr. Chairman, it is our understanding that the Omaha District has been in regular communication with the Assistance Board in determining what the appropriate course, and requirements and actions were with regard to a certification.

I believe Mr. Thor is much better equipped to discuss specifically where they stand with the Omaha District—and it is my understanding that there has been some form of request provided now to them—than I am, or the members of my Board.

We have made every effort to cooperate with both the districts and the Assistance Board to move expeditiously to attempt to resolve their problems in the most favorable way both to the users and to the taxpayers as possible.

It is my understanding—and we have not been a party to those discussions—that Omaha has been very deeply involved in discussions with the Assistance Board on an appropriate course of action, and we felt that we should afford them the opportunity to proceed in an orderly fashion on that matter.

Senator BOREN. Well, we'll have Mr. Thor with us as our next witness, but is it your understanding of the law—am I correct, in quoting the law, section 6.4(b)—that when the book value of the stock is less than 75 percent of par value, that it does say that the System institution is required to request certification?

Mr. NAYLOR. That is correct, yes. Mr. Chairman, they are required to do so. There is a process which they need to go through with the Assistance Board in determining the nature and the type of request that might be appropriate, and how they wanted to proceed, and it is my understanding they have been in intense discussions with the Assistance Board, and Mr. Thor will be in a position to discuss that with you in some detail.

Senator HARKIN. Mr. Chairman.

Senator BOREN. Senator Harkin. Let me just defer to you at this point for your questions.

Senator HARKIN. If I may, on just that one point. Mr. Naylor, let's get it clear then. Section 6.4(b) does state that the institution shall request the Assistance Board to grant certification to issue preferred stock under section 6.27(a).

There is no leeway for that. Has the Omaha bank requested the Assistance Board to grant the certification?

Mr. NAYLOR. It is my understanding, as of today, that there has been a request of some kind, but I have not been the recipient of it. I have been advised that, yes, a request has been made, Senator, but Mr. Thor would have to give you the specifics.

Senator BOREN. I am told that they have been below 75 percent since the enactment of the act. So that it has been below for several months.

Senator HARKIN. Six months.

Senator BOREN. So why have they not been required to request assistance long before now?

Mr. NAYLOR. It is our understanding—although, again, Mr. Thor has been the one in discussions with them—that it was their position, that with the required merger forthcoming, that such assistance would not be required, and there have been discussions moving forward on exactly what, if any assistance, would be needed by that district.

Senator HARKIN. What is your responsibility in this area, Mr. Naylor?

Mr. NAYLOR. Our responsibility, I think, quite frankly, Senator, is if indeed there was a material failure—in the sense that there was no discussion, no effort underway to deal with their problems with the Assistance Board—we would, at an appropriate time, be expected to take some action to require that certification be pursued.

Senator HARKIN. Well, I guess that is really the crux of my question, then. You do have a responsibility. It has been 6 months, and yet from what I hear you saying is that basically you do not really know what's going on. You say ask Mr. Thor.

Now it has been 6 months. You do have a responsibility, and I am asking whether or not you have exercised that responsibility?

Mr. NAYLOR. The specific answer, have we taken enforcement action to require a request for certification, no, Senator, we have not.

Senator HARKIN. The question then is, why not? And is that an acceptable answer for this subcommittee, that no, you have not exercised your responsibility?

Mr. NAYLOR. No, Senator, I think not, but I think the proper answer is that we have been advised by the Assistance Board, as well as Omaha, that they are in good-faith discussions, negotiations, on an appropriate course of action.

They recognize their difficulties, but also apparently believe that they do not necessarily require specific financial assistance, and we have felt it was appropriate—at least I have, and the Board has taken no formal action to the contrary—felt it was appropriate to give them the fullest opportunity to arrive at an appropriate course of action.

Senator BOREN. One of the reasons why we made the requirement and did not make it a matter of discretion in requesting assistance, was that once assistance is requested by the Assistance Board certain supervisory controls also begin to take place.

There is additional oversight provided to make sure that the situation does not deteriorate further. We want to make sure that the best possible advice is being provided by the Assistance Board.

I remember that was a point on which Senator Lugar was particularly strong during the time that we were working on this legislation. I share this concern that if the mandatory provision for applying for assistance at the 75 percent level is not followed, that you could have situations develop that become far worse. We have

seen what's happened in the Jackson District, without additional resources of advice and supervision coming into play as well as the failure to act on doing something financially that might reduce the overall cost of coming in and providing assistance later on.

Mr. Duncan and Mr. Billington, is this matter concurred in by the other two of you on the Board, that you have discretion to postpone acting against a district that does not comply with the law?

Mr. DUNCAN. Mr. Chairman, we have believed, and we have been informed, that there has been extensive, and continues to be extensive good-faith negotiations and discussions between the Assistance Board and the Omaha bank with regard to the certification.

And it has been my belief that the Assistance Board and the bank need an opportunity to undertake those discussions. I have expected that those would result in certification.

I now understand that, indeed, they have resulted in a certification.

Senator BOREN. Well, that has not been my understanding.

Mr. DUNCAN. Excuse me. A request for certification.

Senator HARKIN. It is not so.

Senator BOREN. Senator Harkin.

Senator HARKIN. The requirement to request certification is clearcut under the act. I would just echo what the chairman said. We spent a lot of time on this bill, and I think every comma and every period was looked at, and every "may" and every "shall." We debated the mays and shalls for months.

Senator BOREN. They certainly were.

Senator HARKIN. And whether something ought to be a "may" or ought to be a "shall."

Senator BOREN. We even got advice from members of the audience, on several occasions, as to what words meant.

Senator HARKIN. I think that is right, and so, again, this is clearcut. As I understand it, Omaha is not requesting the certification required under the act. They are asking for some kind of limited certification. Limited. I cannot find that anywhere in the act.

Senator BOREN. There is no such thing as "limited certification" under the law. Well, we can pursue that with Mr. Thor, but I mean, was there a time deadline put in? You know the law does not say if they fall below 75 percent they are excused if they are talking about a request for assistance.

They have been talking about it, I guess, for about 6 months. I have forgotten what day the President signed the bill.

Is there any time deadline, in your mind, Mr. Duncan, on how long we should allow them to talk? A year or two, or three or four, before we say as long as they are talking it is OK, they do not have to follow the law?

Mr. DUNCAN. Well, Mr. Senator, I do not have any intention that a discussion of that sort should go on for a year or two. Indeed, it has gone on for a few months. There was, of course, the need for the Assistance Board to get into place, get up and operating. That took some time. And it is my understanding that discussions began very shortly thereafter.

I have been concerned about the pace of those discussions, but those discussions apparently have come to some fruition, and Mr. Thor and the Omaha bank are in a much better position than I am

to discuss those, since, as I understand it, the conclusions to which they have come are very recent.

I have not yet been briefed on the details of their conclusions.

Senator BOREN. We will take that up with Mr. Thor. Mr. Billington, is your view the same as your two colleagues on this matter?

Mr. BILLINGTON. Well, my view is that—my understanding of the law is that—certification should be requested. I have looked at this situation and it is my understanding that they have been in consultation. They are working on it.

I am rather chagrined that there was no action taken because if you wait until after the mandatory merger, then you have a different capital structure in the Farm Credit bank that is merged. You have a very weak Federal land bank system here that is eligible for assistance.

You have a production credit/FICB system which is not. When you merge the FLB and FICB, apparently they are going to have a little in excess. As I understand it, from information I have the Omaha bank does not want Federal oversight, and that the Assistance Board does not want to provide any more assistance than is absolutely necessary, and it is my understanding this is where the argument hangs up.

I would be less than truthful if I told you anything different from that.

Senator BOREN. Well, we will pursue this with Mr. Thor. Senator Karnes.

Senator KARNES. Yes. Mr. Chairman, I would like to comment taking the lead from one of your comments about the Jackson situation. Obviously assistance is important and the oversight is important when we have a situation that is deteriorating.

Mr. Naylor, or members of the Board, do you have an opinion as to the status of the situation in Omaha? Is it indeed a deteriorating situation? It is my understanding that it is quite a bit different than what we see in Jackson, but you may know about it in more detail. You may or may not be capable of answering that.

That may be something that some of the other people who will be testifying or have inside——

Mr. DUNCAN. Senator, it is not of the same type as the situation in Jackson was. However, it certainly is the case, as Mr. Billington has alluded, that the Federal Land Bank of Omaha has some substantial difficulties.

They are working with considerable effort to stabilize that situation.

Senator KARNES. So I guess I want to know if the situation, in your mind, is getting worse in Omaha, or is it getting better since the President signed the bill on January 6?

Mr. DUNCAN. The stabilization of land values across the Great Plains and Middle West has been of substantial benefit, in the sense that it gave some breathing room within which these institutions can take action to begin stabilizing the quality of their loan portfolio, to undertake the restructurings that the law intends occur, and the Omaha bank has been involved in a range of those activities.

They have also been engaged in ongoing—in recent months—substantive discussion with the Assistance Board, and the act provides

the Assistance Board with the responsibility for discussing those assistance arrangements with the Omaha bank.

While I have been concerned about the pace of the discussions, I am aware that the discussions have been substantive, they have been ongoing, and it is my understanding that very recently they have concluded in some type of conclusion that will result in a request for certification.

I have not yet been apprised as to the details of that.

Senator KARNES. I understand one of the options that was suggested, possibly, is an enforcement action brought by FCA. How long does it take for an enforcement action to follow through? If you had a bank that was unwilling to make a move, and you folks decided that an enforcement action was appropriate how long would it take for that to culminate?

Mr. NAYLOR. Senator, it would depend on the type of enforcement action taken, whether it was a negotiated or a unilateral action, and also whether you could sustain unilateral action if, indeed, the good-faith discussions were underway at the time, that essentially, we are attempting to comply with the law in terms of determining where and how assistance might be provided, and if, indeed, it was required.

In either case, it can become a very lengthy process, before you can actually affect that, if it is contested.

Senator KARNES. So it could take longer for an enforcement action. It would not be mutually agreeable, it could take longer than a month or 60 days. I have heard of some that have taken over a year. I just want the options that are available to you put into perspective. When you go through your consideration of taking this dramatic step, some times it may take a long time, not to say that it should not have been done, but——

Mr. DUNCAN. Senator, imposing an enforcement action on the Omaha bank, or attempting to do so in the face of what, by all evidences, were constructive, good-faith ongoing discussions on the substantive problem involved, could well have taken longer than it took the discussions to result in a request for certification.

Senator KARNES. Thank you, Mr. Chairman.

Senator BOREN. Thanks, Senator Karnes. I think we will move on. I know that this panel will regret being excused from further testimony, but I think that knowing that you would like to remain with us longer, we will move on to our next witness. Again, we appreciate the testimony that has been given and the candor with which you have responded.

We obviously have surfaced here some very, very serious concerns. I would urge you to get back to the subcommittee as soon as possible with the answers to these questions that have been raised today. Keep us informed, as best you can, on these developments.

We are particularly concerned that as we proceed ahead on this Jackson matter and the receivership, and all the related issues there, and that every action is taken to preserve records and anything else that needs to be preserved.

And also, I hope you proceed ahead on the issuance of these capital regulations. I would urge you to, really, in those final regulations, make sure that there is adequate procedures for forbearance for these districts. I know there is a strong feeling on the part of

this Board to get the districts up to the capital structure we want them to be.

We all want that. But we must make sure that we do this on a reasonable schedule that does not push System institutions back into having to make increases in their interest charges to the farmers because, if that happens, we will have defeated the whole purpose of our legislation.

So, I would urge you to be sensitive to that as you try to get the final regulations out as soon as you can.

Mr. NAYLOR. Thank you, Mr. Chairman. We certainly appreciate the dedication and time which you and your subcommittee have given to us, in working on the problems the System has faced, and I appreciate the time you have given me, along with your ranking minority member, so that we can keep you fully apprised, and I assure you we will continue to do so.

Senator BOREN. Thank you very much. Mr. Thor. Our next witness is Eric Thor, the president and chief executive officer of the Farm Credit System Assistance Board.

Mr. Thor, we appreciate your being with us, and we would be happy to receive any opening statement you would like to make. I know that Senator Harkin has to go on to another meeting very quickly. I am going to allow him to start the questioning.

If you would like to summarize your opening remarks, we will put the entire prepared statement into the record, and after that I will turn to Senator Harkin for his questions, since he does have to go on to another meeting.

STATEMENT OF ERIC P. THOR, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FARM CREDIT SYSTEM ASSISTANCE BOARD, WASHINGTON, DC

Mr. THOR. Thank you, Mr. Chairman, and, again, good afternoon. I appreciate the opportunity to come before you and update you on the activities of the Farm Credit Assistance Board since its January 21 founding. And I will summarize my prepared testimony.

I would like to say I am personally, and the Board is, very pleased to announce that last Friday, the Senate confirmed Mr. William W. Erwin as the third member of the Assistance Board. Will Erwin is well-known in Washington to those who care about agriculture, farmers, and ranchers. He is a long-time Indiana farmer, and currently a producer in that State, and also a former official of the U.S. Department of Agriculture.

We, at the Assistance Board, both the staff and the Board, welcome Mr. Erwin to the Board.

As you know, upon the creation of the Farm Credit Assistance Board, it was given the responsibility of working with the Farm Credit System's troubled institutions with impaired stock. Since its inception, the Assistance Board has taken a number of different actions to demonstrate both the flexibility and the workability of the mechanism created by the act.

Under the act, the Assistance Board, after notification by the Farm Credit Administration, can monitor the financial condition, business plans, and operations of a System institution. When conditions warrant, the Board can certify a System institution whose

stock has a book value below par as eligible to receive financial assistance through the issuance of preferred stock and its sale to the Farm Credit System Financial Assistance Corporation. If the Board determines that financial assistance is not appropriate, it may request the Farm Credit Administration to consider a merger or consolidation with other System institutions, the appointment of a conservator or a receiver, or it may take other action approved through the Board.

I will quickly summarize the testimony that I give for the next couple of pages. A number of decisions which trigger the mechanism of the Financial Assistance Corporation, as well as in the appropriation process, in determining the amounts of money that will be needed, are ahead of us.

I also want to point out that the possibility of a severe drought in many parts of the Nation, including several areas served by the troubled Farm Credit System institutions that we are dealing with, is one of the main reasons we need to maintain the flexibility that is built in to our actions.

I did testify before this subcommittee of the Senate Agriculture Committee on the May 23, to discuss the environments in which financial institutions in general, and the troubled Farm Credit System institutions in particular, had operated in recent years.

I will not go through that, but I would like to make sure it is inserted in the record. Clearly, as Mr. Bob Heller, Governor of the Fed from 1983, testified it has been a very difficult year for rural banking systems in total, including nonperforming loans, earning declines, and a number of failures, including those in the State from which I come.

I did want to point out also, that in all our dealings with the troubled Farm Credit System, the Assistance Board has maintained similar priorities. These priorities have been affirmed to us by the farmers and ranchers we have met with throughout the country.

First, we must assure that the farmers and ranchers in troubled farm credit districts will have available credit at competitive rates.

Second, we must protect the borrower stock as required in the act, and third, we must seek the best method for assistance to assure the long-term viability of the System as a whole, realizing that perhaps not all individual troubled institutions can be saved.

We have continued to deal throughout our short stay with five Federal land banks, and one Production Credit Association. We have announced two decisions: first, the Federal Land Bank in Jackson which I went through on the 23rd of May in great detail, and which I will not go through today.

I will, though, quickly point out that we are pleased to report that the farmers and ranchers in those three States are already, in our opinion, benefiting from that decision.

We have interim lending in place which had not been available since December of 1987, and the receiver has mailed checks to all of the eligible borrowers that had paid back their loans.

Again, this has not happened since late last year. And we are confident that the FCA and the System can work out a successful plan for permanent credit services in the three-State area, and we stand ready and able to facilitate that process.

I then wanted to quickly summarize Louisville. Louisville, as you know, was a very serious situation. This was a bank that testified before this committee last year, that in their opinion, without assistance, they would be nonviable. They needed over $790 million according to their estimates last year.

We worked out a very carefully well-thought out and reasonable plan with them for financial recovery. We found strategies that we thought made sense in terms of improving their income, capital structure, loan pricing, loan restructuring, reducing loan risk, reduction of operating expenses, implementation of a comprehensive debt management plan, and a strong effort to preserve remaining capital.

We worked in very close cooperation also with the borrowers, and farmers and ranchers in that area to get that plan in place.

This will enable the Louisville bank to reduce overall expenses by over $140 million over the next 5 or 6 years. The bank should now be able to—and they have already taken steps—to provide credit to the district borrowers at more competitive rates, without weakening the bank's financial condition.

They also have significantly cut their exposure to fluctuating interest rates. We have in fact cut that in half. As you know, that was one of their most serious problems as they did not have the ability to buffet changes in interest rates with their own debt structure.

As a result, if market interest rates rise or decline, the bank should be able to rapidly adjust its loan rates to competitive levels.

Also, the bank, in its own forecasts—and we concur in those—suggest that they could return to profitability as early as 1989. As you remember from their testimony last year, they felt they were nonviable as they were currently structured. So we think we have made some real progress in that area.

Also, the Production Credit Associations in the Louisville district will in fact benefit from that. The PCA borrowers will continue to have access to competitively priced credit and this will greatly assist in the merger process of the land bank and the FICB's, planned to occur on July 6.

The terms and the conditions of the act, as many have reported, is to foster and employ sound management practices. We think Louisville is on the road to recovery.

We are closely monitoring the situation with FCA and Louisville, and we anticipate that a number of steps will be taken over the next couple of years to really shore up the Louisville district.

I then wanted to move on to a subject I believe Senator Harkin would like to discuss—the Omaha District. The Federal Land Bank in Omaha is attempting to utilize its own resources to address its financial problems without direct financial assistance.

The Assistance Board applauds efforts by System institutions to solve their own problems. The Assistance Board has been receiving financial information on the Omaha bank from the bank's management and the FCA, and an analysis shows that the bank has made significant progress in improving its own financial condition over the past 6 months.

In the first quarter of 1988, Omaha reported a profit of over $20 million. On a monthly basis, the last couple of months have shown

similar gains. In addition, Omaha will reduce its impairment through a merger with the Intermediate Credit Bank scheduled for early July.

Nevertheless, the current book value of the stock, participation certificates, and similar equities of the Omaha bank continues to be below 75 percent of par. In accordance with the law the Omaha bank must request certification from the Assistance Board.

The Assistance Board recently sent a letter to the Omaha bank reminding them of their statutory requirements under the 1987 act, and instructing the bank to comply with this provision. I am happy to announce today that the Assistance Board has received a request from the president of the Omaha Land Bank for a limited purpose certification to allow the Omaha Land Bank to participate in the Farmers Home demonstration project as provided by the act, and other purposes that the Assistance Board may deem appropriate.

The Assistance Board has also received a request for financial assistance from the Federal Land Bank of St. Paul. We are in close touch with the bank's management, its board, its farmers and ranchers in the area, and are carefully evaluating the information we have received.

Since the founding of the Assistance Board, we have heard from farmers and ranchers around the country, and they express a number of concerns which I would also like to quickly and briefly summarize.

First, borrowers in the Jackson District are concerned about credit availability and affordability, and about retirement of their stock.

Mr. Chairman, I would like to emphasize to you, that in this district, as in every district we deal with, including Jackson, borrower rights provisions are not mitigated at all by any action or agreement of the Assistance Board. All borrower rights provisions apply in all cases as specified by the act.

Second, there is a concern over the lessening of local control as a result of the receivership in Jackson.

As I have testified previously, for the past several months, the bank's borrowers have had no control over their institution. It was not retiring stock, it was not making new loans, and we received numerous reports from the borrowers who felt that they had no communication with the bank's management.

Concerning joint-and-several liability, even though the statute does provide for this possibility, the Assistance Board has worked to prevent this in two cases already, and continues to believe it has ample authority to work within its resources and authority to avoid the necessity of joint and several liability.

Finally, I would like to point out that the investment community continues to watch our activities very closely. As you pointed out, in maintaining the credibility of, and in the dealings with the System institutions, one of the very important groups is the investment community with over $54 billion worth of debt outstanding. That has an annual interest cost to the System of approximately $5 billion.

The passage of the 1987 act, combined with your efforts, and ours, to implement the act as quickly and as efficiently as possible, has resulted in new investor confidence.

We are, for example, working with the Financial Assistance Corporation on a soon-to-be-announced first-bond issue. We see this as a very positive development so far.

The Farm Credit System, in the long-run, must seek more creative and innovative approaches in the funding of their lending activities and providing financing to their borrowers, Unless System institutions are able to provide specific financial credit services for borrowers that will reduce their overall financing costs, the System institutions will cease to be the significant source of financing in which they properly should be.

There is an ever-increasing multiplicity of financial institutions competing for business through innovative financing techniques.

The Farm Credit institutions need to offer the most favorable terms they can in accordance with their cost structure, or they will be replaced, as they already have, in many instances, with other lenders.

I will not go into all the details of the rest of my prepared testimony, but please include them in the record. I do want to point out that the Special Committee and the Interim Committee have been meeting to deal with the merger possibility, and I also want to point out that the Assistance Board has taken steps to institute the Special Asset Council.

Both Secretary Baker and Secretary Lyng are proud of the Assistance Board's 5 months of accomplishments. We have hired staff, responded to requests for assistance, and dealt with a number of things including shutting down the Capital Corporation, and the numerous lawsuits surrounding that.

Quickly, as I reported to the subcommittee last month, we inherited some 44 lawsuits. We are now under 25, with a substantial possibility we will see a number of them disappear in the next couple of weeks.

We continue to work with the troubled System institutions with diligence, prudence, and by carefully considering all the options of extremely complex legal and financial problems. We intend to apply ourselves in each case, carefully evaluating the best course of action to solve the problems facing each troubled institution, as we have done with the Jackson and Louisville banks.

Thank you, Mr. Chairman, and members of the subcommittee. I will be happy to answer your questions.

[The prepared statement, with an attachment, letter, question and response of Mr. Thor follow:]

Testimony
of

Eric P. Thor

President and Chief Executive Officer
Farm Credit System Assistance Board

before the

Senate Subcommittee on Agricultural Credit
Committee on Agriculture, Nutrition and Forestry

June 16, 1988

Good morning, Mr. Chairman and Members of the Committee. I appreciate the opportunity to come before you today to bring you up to date on the activities of the Farm Credit System Assistance Board since its charter on January 21 of this year.

First, I would like to say that the Board was very pleased to announce last Friday that the Senate has confirmed William W. Erwin as the third member of the Assistance Board of Directors. Will Erwin is well known to many in Washington who care about agriculture. He is a life-long Indiana farmer and a former official with the Department of Agriculture. We are delighted to welcome Mr. Erwin to the Board.

As you know, Mr. Chairman, the Agricultural Credit Act of 1987 authorized the creation of the Assistance Board, giving it the responsibility of working with troubled Farm Credit System institutions with impaired stock. Since its inception, the Assistance Board has taken a number of different actions which collectively demonstrate the flexibility of the mechanism created by the Act.

Under the Act, the Assistance Board, after notification by the Farm Credit Administration, can monitor the financial condition, business plans and operations of a System institution. When conditions warrant, the Board can certify a System institution whose stock has a book value below par as eligible to receive financial assistance through the issuance of preferred stock and its sale to the Farm Credit System Financial Assistance Corporation. If the Board determines that financial assistance is not appropriate, it may request the Farm Credit Administration to consider a merger or consolidation with other System institutions, the appointment of a conservator or a receiver, or it may take other action as authorized by the Act.

Through September 30, 1992, the Financial Assistance Corporation

will raise funds to pay for the purchase of the preferred stock by the issuance of 15-year debt obligations. Congress has authorized the issuance of up to $4 billion for this purpose ($2.8 billion until January 1, 1989 and an additional $1.2 billion thereafter, if certain statutory criteria are met.)

The Financial Assistance Corporation will soon announce its first issuance of debt securities scheduled for July. While it does not appear that the Corporation will approach the issuance of $1.5 billion during this fiscal year, as previously forecast, it is premature to predict the total amount of debt obligations that may ultimately be issued. Caution must remain the order of the day.

The possibility of a severe drought in large parts of our nation is an example of why we need to maintain flexibility in funding. The amount of interest due on the debt obligations issued by the FAC should be driven by the amount of assistance needed by System institutions, and not by the amount of money appropriated for interest payments. Interest on these treasury-guaranteed debt obligations for the first five years will be paid by the U.S. Treasury. During the second 5-year period the interest cost will be split nominally between the Treasury and the System institutions. During the final five years, the System institutions will assume the entire payment of interest. At the end of the 15-year period, the Act requires that the System institutions receiving financial assistance repay the obligations to the extent they are financially able to do so.
System institutions will also ultimately be responsible for the repayment of interest funded by the Treasury.

When I testified before the Senate Agriculture Committee on May 23, I discussed some general aspects of the environment in which financial institutions have operated in recent years. I would like to review the most important points today:

Since 1983, financial institutions of all types have been facing a number of challenges. H. Robert Heller, a Governor of the Federal Reserve System, in his testimony of May 25 before the Senate Committee on Banking, Housing, and Urban Affairs, said "Major segments of the banking industry today confront significant problems and challenges. Indeed, 1987 was an extremely difficult year for our banking system as total nonperforming loans increased, earnings declined, and the number of problem banks and bank failures reached record highs."

Recent failures in savings and loan institutions, commercial banks and investment banking firms that Heller cites point to the fact that there are far-reaching problems common to many financial institutions that are broader than those unique to the Farm Credit System. A recent study by the General Accounting Office, requested by the Senate Banking Committee Chairman

William Proxmire, concluded that many financial institutions in serious trouble today are the victims of management failure, as well as economic and financial factors. And, as we have seen with other financial institutions, recovery may not be possible in all situations.

I could cite many institutions in the private sector which have been recovering slowly; some have failed. In the past three years over 190 agriculture banks have been placed in receivership as the best solution to their financial problems. In the State of Nebraska, where I was born and where my family still farms, 25 banks have closed in the past three years.

As with other troubled financial institutions, some Farm Credit System institutions will recover; some may not. The Assistance Board recently announced two decisions in response to requests by troubled System institutions, the Jackson and Louisville Federal Land Banks. Our actions in response to these requests show that the Agricultural Credit Act of 1987 has provided a workable and flexible mechanism for assisting, when appropriate, financially troubled institutions, and for protecting the nation's agricultural borrowers within the Farm Credit System. The Assistance Board is part of that mechanism, and after five months of intense effort by the Board, the Farm Credit Administration and others, I can report that the mechanism is working.

In all our dealings with troubled Farm Credit System institutions, the Assistance Board has maintained similar priorities. These priorities have been affirmed by the farmers and ranchers we have met with throughout the country. First, we must assure that farmers and ranchers in troubled Farm Credit districts will have available credit at competitive rates. Second, we must protect borrower stock as required in the Act; and third, we must seek the best method of assistance to assure long-term viability for the System as a whole, realizing that perhaps not all individually troubled institutions can be saved.

The Board, to date, is dealing with five Federal land banks and one production credit association that are financially troubled. Their financial and management problems require solutions tailored to the institutions' specific needs. In the five months since the Board was chartered we have found that the flexibility provided in the Act is a necessary and important ingredient in our problem-solving approach. Let me cite two examples.

The Federal Land Bank of Jackson was the weakest of the five banks to apply to the Assistance Board. When I testified before this Committee on May 23 I described in detail the Jackson Land Bank's overwhelming financial and management problems and our eventual decision to recommend to the Farm Credit Administration Board that the Bank be placed in receivership. I will not repeat those details today.

We are very pleased to report that farmers and ranchers in Mississippi, Louisiana and Alabama are already benefitting from our decision. Agreements with other System institutions to provide interim lending are in place and new loans at reasonable and competitive rates are again available to qualified borrowers. The receiver has mailed checks to retire eligible stock to more than 700 borrowers with paid up loans. These services have not been available to Jackson district borrowers since December, 1987. We are confident that the FCA and the System can work out a successful plan for permanent credit services to System borrowers in the three-State area.

During the same week that the Farm Credit Administration Board placed the Federal Land Bank of Jackson in receivership, we took action to assist the Federal Land Bank of Louisville, certifying it as eligible to issue up to $90 million in preferred stock to the Financial Assistance Corporation.

Louisville has had a number of problems, including a high level of nonaccrual loans, flight of quality borrowers, and high debt costs. Today, Louisville has their third set of management since 1983. Despite these problems, the Louisville Bank's Board and management submitted a well-thought-out, reasonable business plan. It is a workable plan for financial recovery; management is strong. Its strategies for improving income and capital include addressing individual loan pricing; emphasis on loan restructuring; plans for reducing loan risk; reduction of operating expenses; implementation of a debt management program, and a strong effort to preserve remaining capital.

The Assistance Board received close cooperation and worked in coordination with the Funding Corporation and the Financial Assistance Corporation to work out a solution with Louisville that will be of great help to the farm credit borrowers in Kentucky, Tennessee, Ohio and Indiana. As a result of financial assistance provided through certification, Louisville should be able to offer improved credit service to its borrowers while maintaining the sound management practices presented to the Board as part of their business and operating recovery plan. Early indications are that the future for Louisville borrowers looks bright.

The assistance agreement with the Louisville FLB will benefit the district's borrowers in many aspects:

- The FLB has significantly reduced its average debt cost and this will enable the bank to reduce its expenses by approximately $140 million over the next 6 years. The bank will now be able to provide credit to the district's borrowers at competitive rates without weakening the bank's financial condition.

- The FLB's exposure to financial risks due to fluctuating interest rates has been cut in half. As a result, if market interest rates rise or decline, the bank will be able to rapidly adjust its loan rates to competitive levels.

- The bank should return to profitability in 1989 and make excellent progress towards meeting FCA's proposed minimum capital standards by 1992. The Louisville District will again have a financially healthy Farm Credit Bank.

- Production credit associations in the Louisville District will also benefit from this assistance. PCA borrowers will continue to have access to competitively priced credit. This will greatly assist in facilitating the merger of the FLB and FICB planned on July 6, 1988.

- The terms and conditions required pursuant to the Act by the Assistance Board in connection with its certification will help ensure that the Louisville Bank continues to employ sound management practices. While the bank is not cured today, it is well on the road to recovery. With good bank management and close monitoring by the FCA and the Assistance Board, the Louisville FLB should soon return to profitability and in time be fully restored to financial viability.

As part of my overview of the implementation of the 1987 Act and commentary on the troubled institutions in the Farm Credit System, we need to examine and compare the liabilities and operations expenses of System institutions, with those in troubled S&L's, commercial banks and other institutions. The Agricultural Credit Act of 1987 gives the Assistance Board the authority to review these factors affecting System institutions seeking certification, which have serious consequences on their financial viability, and to help make decisions regarding their funding alternatives. We are examining the alternatives in each case; and this analysis has been especially important in both the Jackson and the Louisville decisions. These decisions are good examples of the benefits to be gained from the flexibility Congress drafted into the Act, and indicates the degree of financial analysis required in consideration of any proposed certification.

For example, Louisville estimated last year in hearings before this Committee that it would need up to $790 million in direct financial assistance. The Louisville Bank working with the Assistance Board's staff was able to develop an alternative which was substantially cheaper and that ultimately required only $90 million to put the Bank on the path to a viable condition. This investment should save the Louisville Bank somewhere in the neighborhood of approximately $140 million dollars over the next six years. Depending upon future courses of interest rates,

asset and liability management decisions, and asset growth, the Assistance Board action will save taxpayers and the System hundreds of millions of dollars over the next 15 years. The Assistance Board has begun research in this area to facilitate similar savings in the other financially weakened Farm Credit System institutions.

In the Omaha District, the Federal Land Bank of Omaha is attempting to use its own resources to address its financial problems without direct Federal financial assistance. The Assistance Board applauds efforts by System institutions to solve their own financial problems. The Assistance Board has been receiving financial information on the Omaha Land Bank from the Bank's management and the FCA, and an analysis shows that the Bank has made significant progress in improving its financial condition over the last six months. In the first quarter of 1988, the Omaha Bank reported a profit of over $20 million. In addition, Omaha will reduce its impairment through a merger with the Federal Intermediate Credit Bank of Omaha scheduled for the first part of July. The capital stock of the resulting Farm Credit Bank of Omaha will have a book value over 75 percent of par value in accordance with GAAP.

Nevertheless, the current book value of the stock, participation certificates, and similar equities of the Omaha Land Bank continues to be below 75 percent of par value in accordance with GAAP, requiring the Omaha Land Bank to request certification from the Assistance Board. The Assistance Board recently sent a letter to the Bank reminding them of the statutory requirements of the 1987 Act and instructing the Bank to comply with its provisions. The Assistance Board has today received a request from James D. Kirk, the President of the Omaha Land Bank, for a limited purpose certification to allow the Omaha Land Bank to participate in the Farmers Home Administration demonstration project as provided in the Act.

The Assistance Board has also received a request for financial assistance from the Federal Land Bank of St. Paul. We are in close touch with the Bank's management and Board, and are carefully evaluating the information we have received.

Since the founding of the Assistance Board we have heard from farmers and ranchers around the country, as they express a number of concerns. I want to address several of them today.

First, borrowers in the Jackson District are concerned about credit availability and affordability, and about retirement of their eligible stock. We want to assure Jackson borrowers that their loans will continue to be serviced. The agreements for temporary service by other FCS institutions provides that new loans will be available and interest rates should be more competitive. Mr. Chairman, I want to emphasize that in no

district, including Jackson, should the borrowers rights provisions be mitigated by any action or agreement of the Assistance Board. All borrowers rights provisions apply in all cases as specified in the Act.

Second, there is concern over a lessening of "local control" as a result of the receivership. For the past several months, the Bank's borrowers have had virtually no control over their institution. It was not retiring borrowers' stock as loans were repaid, it was making no new loans, and we have received reports that borrowers felt there was a lack of communication between them and bank management.

Third, regarding long-term credit service and the continuation of lending in the Jackson District, both the Assistance Board staff and FCA officials have met with officials of various Farm Credit System institutions and others to discuss proposals for providing permanent service to borrowers in the 5th District. These discussions are ongoing and the Assistance Board stands ready to assist in facilitating permanent service arrangements.

Fourth, we are aware of concerns regarding the joint and several liability for all System institutions. Even though the statute provides for this possibility, the Assistance Board is working to prevent a situation which results in joint and several liability. The assistance to the Jackson Bank provided in February and May avoided this consequence. We believe that we have ample authority and resources at our disposal -- as well as good reason -- to avoid the necessity of joint and several liability.

Finally, we know that the investment community is watching this situation. The System has approximately $54 billion in debt outstanding, at an annual interest cost to the System of roughly $5 billion. The passage of the Agricultural Credit Act of 1987, combined with our efforts since then to implement the Act as quickly and efficiently as possible, has resulted in increased investor confidence which is reflected in the narrowing spread between System bonds and Treasury obligations of comparable maturities. The attached graph (attachment) illustrates how the spread narrowed from a peak of 150 basis points last October. As of June 15 that spread is around 65 basis points. The System's total debt should benefit from narrowed spreads, which could save the System several hundred million dollars in the next few years and reduce significantly the amount of taxpayer assistance required.

In the long run, the Farm Credit System must become far more creative and innovative both in funding their lending activities and in providing financing to their borrowers. Unless System institutions are able to provide specific financial credit services for their borrowers that reduce their overall financing costs, System institutions will cease to be a significant source

for financing. There is an ever-growing multiplicity of financial institutions constantly competing for business through innovative financing techniques. Unless Farm Credit institutions offer more favorable terms in accordance with their cost structure, they will be replaced by other lenders. For example, commercial institutions are trying to make great inroads in the loyal customer base of the banks for cooperatives by luring them from the BCs with commercial paper offerings and specialized credit lines.

This competition will provide a good era of financing for farmers, ranchers, fishermen and their cooperatives. These borrowers will benefit from increasingly lower financing costs and financing more convenient to the manner in which they do business in rural areas. System institutions must meet the challenge in a manner that enables them to operate independent of Federal financing and funding, or they may lose business and incur losses.

In addition to working with individual System institutions, the Assistance Board is also implementing the formation of the Special Committee on District Consolidation and the National Special Asset Council, as outlined in the Act.

The Special Committee on District Consolidation is charged in the Act with developing within six months a proposal for the consolidation of the Farm Credit System banks into no less than six financially viable Farm Credit Banks through inter-district mergers. The Committee is composed of a representative from each Farm Credit Bank Board and the members of the Board of Directors of the Assistance Board. An interim committee met on May 11 in Denver to begin work. Merger proposals may not be submitted to stockholders unless approved by a majority of the Board of Directors of the Assistance Board, members of the Special Committee who represent affected districts, and the Farm Credit Administration.

The Assistance Board is also establishing the National Special Asset Council, as required by the Act. The Council has two specific functions: (1) to monitor compliance by Farm Credit lenders certified by the Assistance Board and their district special asset groups, with statutory restructuring requirements; and (2) to review a sample of determinations by these district special asset groups of loans that were not restructured.

It is intended that the Council will coordinate with FCA to utilize FCA examiners to conduct field reviews of restructuring denials made by special asset groups. The Council will make regular reports to the Assistance Board.

Mr. Chairman, I will close by saying that I am proud of what we have accomplished since the Agricultural Credit Act of 1987 was

enacted 5 months ago. Even before the Assistance Board was chartered, Secretaries Lyng and Baker moved quickly to establish the Board, hire staff, and respond to requests for assistance that they knew would be forthcoming. As required, the operations of the former Farm Credit System Capital Corporation were closed down. Within 15 days of the Board's charter, we retired more than $113 million in Capital Corporation stock. Following extinguishment of other former Capital Corporation liabilities, any remaining surplus will also be distributed to the stockholders. In March we completed agreements that permitted the retirement of $20.5 million in frozen stock to farmer and rancher borrowers in three western states.

The Assistance Board inherited from the former Farm Credit System Capital Corporation 44 lawsuits filed by Farm Credit System banks, associations, and individuals against the former Capital Corporation. The Board has been actively pursuing through the Department of Justice various options in an effort to bring about dismissals, and today only 25 remain outstanding. Of the 19 lawsuits challenging the assessment process established pursuant to the Farm Credit Amendments Act of 1985, only eight remain. The Assistance Board, through negotiations lead by the Department of Justice expects dismissals of seven of these lawsuits within the next two weeks.

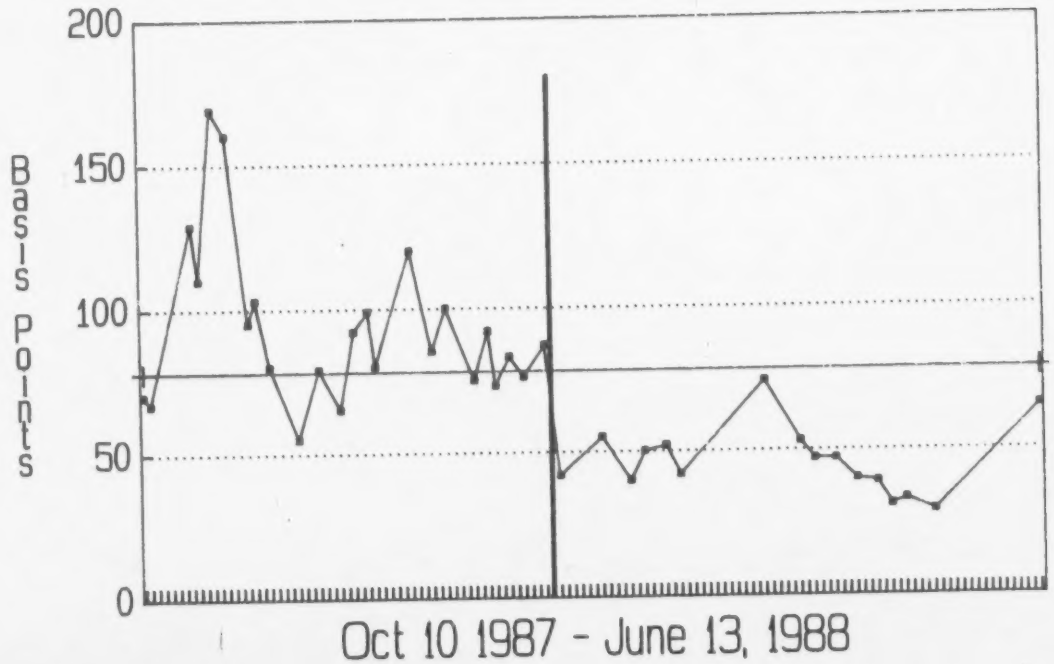
The Assistance Board is working with other troubled System institutions and is doing so with diligence, prudence and by carefully considering all the options of extremely complex legal and financial problems. We intend to apply ourselves to each case, carefully evaluating the best course of action to solve the problems facing each troubled institution, as we have done with the Jackson and Louisville Land Banks.

Thank you, Mr. Chairman. I will be happy to answer your questions.

Attachment follows:

YIELD SPREAD: 6-MO FFCB & T-BILL

Closing Bid Yields



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JOHN WELLONS, MONTANA
DAVID H. PRYOR, ARKANSAS
DAVID L. BOREN, OKLAHOMA
HOWELL HEFLIN, ALABAMA
TOM HARKIN, IOWA
KENT CONRAD, NORTH DAKOTA
WYCHE FOWLER, JR., GEORGIA
THOMAS A. DASCHLE, SOUTH DAKOTA
JOHN B. BREAUX, LOUISIANA

RICHARD G. LUGAR, INDIANA
ROBERT DOLE, KANSAS
JESSE HELMS, NORTH CAROLINA
THAD COCHRAN, MISSISSIPPI
RUDY BOSCHWITZ, MINNESOTA
MITCH MCCONNELL, KENTUCKY
CHRISTOPHER S. "KIT" BOND, MISSOURI
PETE WILSON, CALIFORNIA
DAVID S. KARNES, NEBRASKA

United States Senate
COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

July 12, 1988

Mr. Eric Thor
President and Chief Executive Officer
Farm Credit System Assistance Board
Suite 702
1301 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear Mr. Thor:

We appreciate your testifying before the Committee on June 16, 1988. Enclosed are additional questions which are being submitted to you for written answers. We would appreciate receiving your answers to the questions by July 29, 1988 so that the hearing record may be printed as soon as possible.

Thank you for your cooperation.

Sincerely,

DAVID L. BOREN
Chairman
Subcommittee on
Agricultural Credit

Questions from Senator Tom Daschle
Hearing on the Implementation of the Agricultural Credit Act of 1987
Senate Agriculture Committee
June 16, 1988

ERIC THOR, FARM CREDIT ASSISTANCE BOARD

We have heard over and over again that the value of the stock in Omaha is below 75%. Can you please tell me, whether or not they have requested certification and if not why not?

FARM CREDIT SYSTEM ASSISTANCE BOARD

Suite 702
1301 Pennsylvania Avenue, NW
Washington, DC 20004

(202) 737-9255

JUL 25 1988

Honorable David L. Boren
Chairman
Subcommittee on Agricultural Credit
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I am enclosing my response to the question submitted by Senator Tom Daschle to be made part of the record of the hearing on the implementation of the Agricultural Credit Act of 1987, held on June 16, 1988.

Please let me know if I can be of further assistance.

Sincerely,

ERIC P. THOR

ERIC P. THOR
President and Chief
Executive Officer

Enclosure

LAPIS:JK:sfc:7-22-88

Call	Initial & Date		Initial and Date
Lapis	JC 7/22		
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Question from Senator Daschle:

We have heard over and over again that the value of the stock in Omaha is below 75 percent. Can you please tell me whether or not they have requested certification and if not, why not?

Answer: The Federal Land Bank of Omaha requested certification by letter to the Assistance Board on June 16, so that Omaha district borrowers would be eligible for reduced interest rates as part of the demonstration project included in the Agricultural Credit Act of 1987. Subsequent to the July merger of Omaha Farm Credit System institutions into the Farm Credit Bank of Omaha, the Omaha FCB plans to submit a business plan to the Assistance Board outlining its proposal for financial assistance. The Assistance Board will analyze very carefully the information received from Omaha, and will recommend action according to its findings.

Senator BOREN. Thank you very much, Mr. Thor.

As I indicated, Senator Harkin must leave to go to another meeting, so I am going to defer to him to begin the questioning, and he has said he may submit some other questions for the record.

We have also been joined by our colleague, Senator Exon of Nebraska. We welcome you, Senator Exon and invite you to participate with us during the questioning here. Senator Harkin.

Senator HARKIN. Thank you very much, Mr. Chairman. I appreciate your kindness here to me.

Mr. Thor—and perhaps I have some questions for Mr. Kirk who I see is in the audience. Let me just say, at the outset, that I have some split feelings on this Omaha situation.

First of all, the president of the bank, Mr. Kirk—who is in the audience here today—has worked very closely with my staff, and with me, to resolve problems. They have had a very difficult task and they have worked very hard at it.

I also want to say that under Mr. Kirk's leadership, the Omaha bank has cut their operating costs, they have attracted new business, and I might say that what is most important for me is that they have implemented the borrower rights provisions better than any other district in this country.

So I sort of have some split feelings on this matter because they have done a good job, in many ways, but I also feel that there is one area that just must be addressed, and that is this area of requesting certification.

And I do not mean to let it go because of the good things, the other good things that they have done, because I feel that there are certain elements, certain things that take place after certification that are most important for three classes of people—for the farmers that have some land out there, for stockholders, and for the taxpayers of this country.

Now, it may be that when they merge in July, that you put the land bank in with the other two, and the System will look good again, it will be healthy. That may well be.

But unless they request certification, as is mandated by law, these other provisions will not come into play. Now, you said that you were happy to announce that they have applied for limited purpose certification.

Mr. Thor, could you please tell me what section of the law allows for limited purpose certification. Maybe I missed that.

Mr. THOR. Senator, section 6.5(a)(4), and let me read that to you. It states: "The Assistance Board shall assist an institution that has been certified under 6.4 by providing assistance by such other methods as the Assistance Board deems appropriate" or determines appropriate.

Now as I pointed out in my testimony, the certification that they have requested is for not only the pilot program, for other purposes as the Assistance Board deems appropriate.

So that is the section that we are using in the law, and that is what we have called the limited purpose certification.

Senator BOREN. Well, Mr. Thor, let me say, I think that is clearly against the law. That is not what we passed. Yes, of course, we want to give you flexibility to do other things, other than just to

supply cash. We have given you the flexibility to do that. That section is in there so that you can give other kinds of assistance.

But you read on down, and it says, "minimum equity value," and "The Assistance Board shall authorize a certified institution to issue preferred stock under the appropriate provisions, sufficient to maintain the value of stock, participation certifications, and other equities, at no less than 75 percent of the par value of the stock or the face value of the certificates or equities," and so on.

We debated that a long time, and we were afraid that the Assistance Board might not do that. We had the suspicion that you might not want to spend any money, and many of us felt very strongly that not putting sufficient money in, and in a timely manner would cause the situation to get worse.

That is the reason we said that in providing assistance you shall issue the stock. That means putting cash into it sufficient to bring the level up to 75 percent of par value. That is not discretionary; that is mandatory under the law.

Senator HARKIN. Mr. Chairman, if I might back up a little bit. The section you read from Mr. Thor, is 6.5(a)(4). Let me just read the earlier part of that section. It says—you have it right there—look at section 6.5(a), which says, "The Assistance Board shall assist an institution that has been certified under section 6.4."

Let us go back to section 6.4. When we debated this language, we said if their book value is a little under 100 percent of par, well, maybe they should and maybe they should not request certification, but we said that at below 75 percent they must request certification. We even debated the level for a while.

Senator BOREN. We did.

Senator HARKIN. We said that if they are below 75 percent of par, they have to request certification. That is what it says in 6.4(b)—the institution shall request the Assistance Board to grant certification to issue preferred stock under section 6.27(a). The answer you just gave me under 6.5(a)(4) comes after that language.

Again, this clearly is not within the law for them to request some limited kind of certification for which they spell out what they want. That is up to you to decide.

Mr. THOR. Senator, I will be happy to put forth a legal brief to you on this, but section 6.5 sets the methods by which we can provide assistance.

Senator HARKIN. After they have requested certification.

Mr. THOR. That is correct, and as I told you they have——

Senator HARKIN. But they have not requested certification.

Mr. THOR. No, they have, Senator, today they have requested certification from the Assistance Board.

Senator HARKIN. Under 6.4(b)?

Mr. THOR. Yes, they have.

Senator HARKIN. Oh, they did not request limited certification?

Mr. THOR. No, I said "and for other purposes."

Senator BOREN. So they requested certification?

Mr. THOR. They requested certification, Senator.

Senator BOREN. All right. Have you acted on that yet?

Mr. THOR. No, Senator, we just received it this morning.

Senator BOREN. Oh, this morning.

Mr. THOR. Yes.

Senator BOREN. That is good timing.

Mr. THOR. That is why I said, Senator, I was happy to announce that the request has been received by the Assistance Board.

Senator BOREN. We labored over this so long, I am glad they finally decided to read the law and comply with it. On the day we have the oversight hearing, they finally decided to abide by the law and request assistance.

Senator HARKIN. Mr. Chairman, I want to make this perfectly clear before I yield to my friend from Nebraska. In your written statement, on page 6 [see page 228], you say the Assistance Board has today received a request from James D. Kirk, president of the Omaha Land Bank, for a limited purpose certification. Now you have told me it is not limited purpose.

Mr. THOR. It is for limited purpose certification and other purposes, which means it applies to section 6.4. I was just seeking from Ken Peoples, my counsel, just exactly what the letter says.

Senator BOREN. There is no such thing as that. You know, you all are going to have a very difficult time sending a legal brief, to the people who wrote the law, and we not only wrote it in passing. It was not even the staff who wrote the law; the members of this subcommittee wrote the law. We debated this for days and days and days and we know exactly what we meant and why we meant it.

If you go back and read the minutes of the subcommittee meetings, you will find we did not want to leave certain things discretionary. We said when the par value falls below 75 percent, you shall request assistance, and we said if there is certification the Assistance Board shall bring stock up to 75 percent of par value at a minimum. Now, you may do other things as well if you wish, that is why these other things are in here, however you must do those things because we did not want you to have the discretion, we did not want to be flim-flammed by the bureaucracy once again and by not providing the assistance this subcommittee intended to provide. Otherwise, this law is not worth the paper it is written on.

We have heard from the FCA about what they are trying to do to push the System with the capital requirements. Now, if they push the System, under the capital requirements, up too fast and the System has to raise the interest rates back to the farmers, and we have the Assistance Board feeling that they can sit back and not bring these districts up to 75 percent of par value with cash—that is money, you cannot do that with smoke and mirrors like we balance the budget—we intended this to be real, then the districts can get out of supervision. [Laughter.]

You see, it is very convenient, the district does not want supervision about the way they have been running their land banks, so they do not apply for assistance so they do not get the supervision. The Assistance Board does not want to give out any cash, so they negotiate about this for months and it serves the purpose of both. The Treasury Department does not want to give out any cash and the institution does not want any supervision, and it is just wonderful for everybody except the farmers involved in this who are the ones we passed this law for.

Now, I think it ought to be pretty clear. We know what the law is and this subcommittee, if it is necessary, as far as I am con-

cerned, I will try to get this subommittee to take legal action to get the law carried out. Do not send us a legal memorandum telling us what this subcommittee intended. We wrote the law. We know what we intended. You know, this may be wonderland, but there are some things we know around here. We know what we thought and we know what our debate said and we know what the record will reflect and that is a clear violation of intent.

We do not want collusion between districts that do not want supervision and a government that does not want to give out any cash in order to solve a problem. Is there an answer to that or is that not what you are doing?

Mr. THOR. We hear you loud and clear, Senator.

Senator BOREN. Follow the law. Follow the law. Do not talk about following the law for 6 months, follow the law. That is what I want.

What about Louisville? After the assistance was provided, did it bring Louisville up to 75 percent of par value, or was the law violated? You certified them, you gave them assistance. Are they now at 75 percent of par value?

Mr. THOR. Again, Senator, they are going to be over the 75 percent after the merger.

Senator BOREN. It does not say that. It says when you certify them for assistance, they are going to have to be up to the 75 percent of par value. So they are not at this time up to par value, 75 percent of par value.

I am not trying to be unfair, and I want to say this: There are many things that Mr. Thor has done that I appreciate. He is a very straightforward person and we have not been saddled with somebody who follows the usual bureaucratic procedures. He talks in a straightforward way and he is not afraid to take action and he has taken a lot of good actions. I want that reflected in the record as well, and I have told him that and I believe that.

But, I have to say that all the time we were debating this bill, we had this very strong suspicion, very strong suspicion, that a way would be found by whichever administration it would be—and I do not care whether it is this one or the one that comes after it—every administration is going to have the intent not to want to spend any money, and we had the strong feeling that by not doing so you would increase the problems and end up with larger liabilities down the road. You know, you are penny-wise and pound-foolish, so to speak, and therefore we wanted two things. We wanted to get the money out as quickly as possible, in order to bring the par value up, and we wanted supervision from the Assistance Board to be put in place as soon as possible and we were very worried about that.

I would say that if there were any two themes that went through all of our markup, it was concern about those two basic points. That is the reason we are focusing on it and we understand that there are debatable points here and we are not indicting the whole Omaha District, by any means, or the management. As Senator Harkin has said, there have been some very good things that are being done now under the leadership that is there and we do not want to create an unbalanced picture here. But we are really concerned about that, and then the FCA action on the capital require-

ments, you take all those three things together and you could subvert the whole basic purpose of the bill and that is what we are worried about.

Is that a fair statement, Senator Harkin?

Senator HARKIN. Right on target. I am concerned that after July, after the merger, when the value comes back up again because of the merger, that that would at that point preclude you from taking actions that you would take under the certification process.

Mr. Chairman, there are a lot of things that take place once the bank requests certification under the act. It is not only the requirement for the issuance of the preferred stock. That is one action that they have to take to bring the book valve up and, as you said, we debated that a long time, we talked about that a long time.

But we thought there were other important things that should take place at the same time, again to protect the shareholders, the taxpayers, and the farmers.

Senator BOREN. The Special Asset Council and other things that are needed.

Senator HARKIN. The Special Asset Council is to review restructuring decisions. Now, are you going to put the Special Asset Council in place? Is that going to be done for the Omaha District?

Mr. THOR. Senator, in my testimony that I skipped over, I said that the Special Asset Council is in formation. We have an executive secretary already appointed and the Council is in the process of being formed right now, and specifically in the next week or two they will be visiting Louisville to make sure the mechanism is set up in that district which, as you know, is our first certification. So, yes, it is up and running from the point of view of having an executive secretary and we are in the process of forming it right now.

Senator BOREN. That is part of the receiver in Jackson, as well?

Mr. THOR. Yes, it does.

Senator HARKIN. And Omaha?

Mr. THOR. Again, Omaha has requested that we look at——

Senator BOREN. If Omaha is certified, it would apply?

Mr. THOR. If Omaha is certified, that would be the case.

Senator HARKIN. One last thing, Mr. Chairman, and I want to get Mr. Thor's thoughts on this: Without this certification, the farmers in the Omaha District would be denied the participation in the demonstration project portion of the act. This demonstration project extends the FmHA interest buy-down program, which was established by Senator Zorinsky, I might add, and it would make funds in the FmHA program available for interest assistance to family farmers to buy inventory property from the Omaha Bank.

This interest assistance is coupled with a 90 percent guarantee for the lender and a lower 15 percent minimum downpayment. The funding for this is in place, the loan guarantees are all in place, but it is my understanding, because the Omaha Bank has refused to apply for certification, that the family farmers that are within the Omaha system are denied this opportunity for these special terms.

As a result, the pattern of inventory sales to investors and others who can pay cash or afford current high downpayments will continue across the Midwest. I point to the one that took place in St.

Paul, where they sold, what was it, 20,000 acres of land to three limited partnerships. That is——

Mr. THOR. Again, I have only cursory knowledge of that, obviously.

Senator HARKIN. Again, without this special demonstration project provision, those family farmers that are out there that could apply for these special provisions will be denied it, but the funding is there. Senator Zorinsky made sure of that, and everything is in place. So that is another element, Mr. Chairman, that I am very concerned about here, that if they do not apply and you do not certify, if we move ahead under the merger——

Senator BOREN. The pilot project does not take place.

Senator HARKIN. It does not take place. Now, what can you——

Mr. THOR. Let me clarify a couple of things. First of all, the regulations are not even out yet for the pilot project. My understanding, having talked to the Farmers Home Administration here in the last 24 hours, is they may be published as early as Friday on a proposed rule basis, which means that the earliest they could potentially be available for a farmer or rancher in any district, Jackson, Louisville, wherever, would be mid-summer, sometime in mid- to late-July.

Again, we are looking and now working with the Omaha District and have been for the last few months to bring that into focus. We do hear you on that pilot project and——

Senator HARKIN. So you can assure me, sitting here today, of that because of the request for certification—not limited purpose certification—that they have requested certification under the act, right? That has taken place?

Mr. THOR. That is correct.

Senator HARKIN. Not as you said in your statement, it is not limited certification, it is certification under section 6.4——

Mr. THOR. Again, with the permission of the Omaha Bank, I will be happy to submit the letter by which they requested it.

Senator HARKIN. Section 6.4(b), that is——

Senator BOREN. It is a request for certification?

Mr. THOR. Yes.

Senator HARKIN. OK. And can you also assure me that even though the merger that would take place in July would lift that book value up above the 75 percent, that indeed the provisions for the pilot project, the demonstration pilot project would still be in place, would still run with this request for certification today?

Mr. THOR. Again, Senator, I cannot prejudge how my Board will decide, but I assume it will be management's recommendation, that that be put in place.

Senator HARKIN. But they would still be eligible for it, that is all I am saying. Even though their book value is above the 75 percent of par.

Mr. THOR. That is correct, Senator, until they get to the point of being at 100 percent. At that point, they cannot effectively request certification from us. So they will be eligible even after the merger to participate in that project if they are certified by the Assistance Board.

Senator HARKIN. Well, I think that really answers my question.

Senator BOREN. And the supervisory requirements would also come into play if they are certified?

Senator HARKIN. The Special Asset Council.

Mr. THOR. Again, we are under negotiations right now with both the Omaha District and the Board and, you know, that has been our way in which we have operated.

Senator BOREN. Again, I would urge you to read the law, because the law says there is only one certification, only one certification, and if someone is certified, it says exactly what comes into play if they are certified, and certainly supervision by the Special Asset Council is one aspect, eligibility for the pilot project is another. All of those things come into play. It does not say you can partly certify and partly come under what automatically happens if you are certified. It says you request certification and then if you are certified, these things follow, and that is what we meant. It is not report language, it is the law.

Senator Karnes.

Senator KARNES. I think I understand the discussion. It has been a very informative discussion. I would like, Mr. Thor, just to again echo what the chairman has indicated, that the request that has been made is a request for certification, yet you have a great deal of discretion in determining what tools within the assistance package that is included in the act are available so that you can not only maximize the use of the resources at the district bank level, but also minimize, to the extent possible, the impact on the taxpayers, and you have a whole quiver of arrows, if you will, that you can draw on to help deal with the problems.

When you were talking about limited purposes—and I agree with the chairman—it is confusing when you look at your statement. But when I read the statement and I had a chance to talk at great length with people at the Omaha Bank, they are concerned about several implications of certification, particularly this demonstration program. It is my understanding that this is one of the things that they would very much like to see implemented as a part of the overall package. They are requesting the Assistance Board to do a number of things that they feel particularly important to help them and farmers in the district.

Although their request may have characterized certain things as being more important than others, as far as guaranteed assistance or availability of programs like the demonstration program, the characterization of it being anything short of full certification is probably maybe a misnomer. The request is for certification, but they are looking for certain things from the certification that you can provide on a priority basis. Of course, you will make the decision, or your Board will make the decision, as to what other things are going to be necessary to make sure that that bank stays a viable bank.

Mr. THOR. Again, Senator, in all you have pointed out, I think the key is to appreciate that the bank, along with its board of directors, who are farmers and ranchers in the area, not only participates in the process, but also helps shape whatever assistance package is requested of the Assistance Board. The bank has been doing that and they have been working with us during a period in which obviously there have been a number of issues at the Assistance

Board. We will make every effort to deal with this certification request and whatever appropriate action the Board feels it should take, we will try to take as quickly as we can.

I personally feel that putting too much money into an area can be as damaging as to put too little, because by putting too much in, all you are doing is burdening the System, causing the farmers and ranchers of this country to pay more back ultimately 15 to 20 years from today. It is not our purpose not to put out money. We want to put it out. I think we have shown we can. We are trying to be very prudent about it, though, because of the financial and legal complexities.

Senator KARNES. Mr. Thor, how long would it take for your Board to make a determination on the request from the Omaha Bank?

Mr. THOR. Again, we are in the process of trying to get our third member up and operating, and as soon as that is done we think we can move very quickly to deal with the Omaha situation. I hate to speculate on an exact date, with the various schedules of the three individuals being very difficult. Sometimes it takes me a little while to arrange it, but I will try to do it as quickly as possible.

Senator KARNES. Thank you.

Senator BOREN. Senator Exon.

STATEMENT OF HON. J. JAMES EXON, A U.S. SENATOR FROM NEBRASKA

Senator EXON. Mr. Chairman, thank you very much, and I appreciate the fact that you have allowed me to come in to ask some questions today on a subject that I have been very much involved with for a long, long time.

I also wish to thank you, Mr. Chairman, and you, Senator Harkin, I could tell by the questions that have been asked here that our numerous personal discussions on this particular matter over the last 2 or 3 weeks have paid off to the extent that we are beginning to get some answers that I thought were obviously necessary.

Mr. Thor, let me ask you this question, to clarify this once and for all: If I understand it, as of now the Omaha District has asked for certification under the law that they had refused to ask for previously, is that right?

[Material submitted by Senator Exon can be found on pages 591 to 594.]

Mr. THOR. Again, Senator, the Omaha Bank, the Assistance Board, the farmers and ranchers in the area and the board of directors have been in numerous discussions and exchanges of information, as required by the act. At no time have they refused to apply. They have been putting together their certification package, discussing it in great detail with ourselves, with their boards of directors, with the farmers and ranchers in the area.

I notified them in writing of the requirement to apply, and they responded quickly and, as I understand it, even had to telephonically get all their board members together so they could respond. So I do not believe that they have been refusing to seek certification.

Senator EXON. Then you have not been reading the newspaper stories and you have not been reading the advice that they have been receiving from some sources, because in the press and in personal conversations that I have had with the Omaha District, they said that they did not see the need for certification and they did not intend to proceed with that proposition.

Let me see if I can ask this question of you once again. For whatever circumstances or whatever reason, the Omaha District has now, as of minutes ago or hours ago or sometime today or sometime this week, finally asked for certification under the law, is that correct?

Mr. THOR. That is correct, the Omaha Bank has applied for certification under the law.

Senator EXON. I am delighted to hear that, because I am the only elected public official in Nebraska that has been demanding that that take place for a long time, and I congratulate the Omaha folks for finally coming to the realization that this was obviously necessary for reasons primarily involved around the demonstration project.

Mr. Thor, have you or your organization discouraged or encouraged the Omaha District to either apply or not apply under the clear mandate of the law, as has been brought out in testimony here this morning?

Mr. THOR. Again, Senator, we have had numerous discussions with the bank. I personally, as you know, have been out there in Omaha several times gathering information. They have been dealing with it at their board level, at their management level, and with the farmers and ranchers. Senator, as you know, my family comes from a farm background and——

Senator EXON. Cuming County, I believe, right?

Mr. THOR. Actually, Stanton County, Nebraska, sir.

Senator EXON. Stanton County.

Mr. THOR. The bottom line is I think we have encouraged them to do a very thoughtful review process so that they could come up with the best plan for the farmers and ranchers of Nebraska.

Senator EXON. That is a given, I think. I would simply say that what has made me terribly unhappy is the fact that I recognize that a relatively good job has been done in Omaha, they have made some significant strides, as has been brought out here, and I associate myself with the remarks of my colleagues in that particular regard.

But I felt it was terribly wrong that they were not following the law, when their stock is clearly below 75 percent, it is clearly mandated by that and at least the Omaha Board has now brought themselves into compliance with the law. Now, what happens next?

Let me ask you this question: What has the Assistance Board done to date, constructively dollarwise, to be helpful with the Louisville and the St. Paul Districts? I am leaving out the Jackson proposition in the South, because I know that you have done some things there. Has the Assistance Board done anything to date, and, if so, what? You could not do anything to help Omaha because they just applied, so I know that. What has the Assistance Board done as of now to help Louisville or St. Paul?

Mr. THOR. Well, again, as my testimony clarifies, Senator, we have certified the Louisville District, we have provided them $90 million in assistance, which was the amount we felt that was appropriate to deal with their significant problems in their operations and their high costs. We will save the farmers and ranchers in the Louisville area $140 to $150 million over the next 5 or 6 years. It provides the bank a base for financial recovery not only through the merger process but through a business and recovery plan we demanded and their board, the farmers and ranchers and their management have all agreed to. It puts in place a number of management controls to help ensure that viability is indeed long term, not just short term.

In the last 30 days, as reported by the press, the St. Paul Bank has also applied for approximately $125 million worth of assistance. We are studying that. They asked us to get back to them by the end of the month. We are working diligently on that request. We intend to get back to them as requested sometime later this month. They have asked for a response by the 24th and we think we can meet that date.

Senator EXON. So the answer is that you have acted and done some things that are obviously necessary for Louisville, you still have the St. Paul situation under advisement, is that right?

Mr. THOR. That is correct, Senator.

Senator EXON. And the Omaha District, with the welcome news that you brought here this morning, would be placed in the same category as St. Paul right now, and obviously you have not had time to act as far as Omaha is concerned yet. Is that a fair appraisal of the situation?

Mr. THOR. Yes, Senator. There has been a great deal of interest in Omaha from many, many sides and, again, we will act as expeditiously as we can.

Senator EXON. One last question, I think is all I have, Mr. Chairman. Certainly, with the drought that is affecting large sections of the Nation, particularly large sections of the Omaha District, this must be a concern to all involved in this process. Is it not additional good news that, in your view, the Omaha Board has finally asked for this certification, because I suspect that possibly the upcoming losses that they might sustain if the drought persists, would be another potential problem in the immediate future for the Omaha Farm Credit System, is that correct?

Mr. THOR. Again, Senator, as I covered in my formal testimony that I did not review, the flexibility that the Assistance Board has built into its actions allows it to respond to changing conditions like the drought in its continued development. That is an on-going situation that is day by day right now. The Assistance Board will obviously have to facilitate should it have serious financial impact, which it looks like it is going to, in certain districts, especially in the Omaha and St. Paul Districts.

Senator EXON. But with the request for certification that finally came as late as it was, that will give the Omaha District—that is a wise move, is it not, from the standpoint of they could be facing additional problems that they did not anticipate 6 months ago because of the drought?

Mr. THOR. As I said, the main thing is that it does provide us that flexibility, and I guess I would characterize it as an important tool in dealing with the Omaha situation.

Senator EXON. Thank you, Mr. Thor. Let me publicly thank the Omaha Bank for finally coming to terms with the law.

Thank you, Mr. Chairman.

Senator BOREN. Thank you, Senator Exon.

Mr. Thor, let me ask you this: I have been trying to sort through this situation about the 75 percent, given the fact that you have the mandatory merger coming up on, what is it, July 6, is it?

Mr. THOR. Yes.

Senator BOREN. So we are in a very unique period here which is not going to recur again. In other words, once mandatory mergers of the FICB's and land banks occur in all of these districts, then we will know exactly the situation. If an institution falls below 75 percent, it is the combined entity that has fallen below. In this situation in Omaha, where you know that you are going to be above 75 percent after the merger, but you are not there yet, they have a mandatory obligation to request certification, you have a mandatory obligation if you decide to do it, to bring them up to 75 percent, to authorize them to issue stock to bring them up to 75 percent. But, what you are saying to me, which makes good sense—I do not want to imply that it does not—you are saying, well, why use a lot of cash there that is unnecessary when you know that on July 6, after the mandatory merger, they are going to be up above this 75 percent level.

I would urge your legal staff to look at this again. We do not want to water down the aspect of the mandate of the law to apply for certification and the mandate of the law, in addition to your other tools, that if you grant certification you must authorize the issuance of preferred stock to bring it up to 75 percent.

Now, I understand, however, that while a district is mandated by law to apply, and then let us say that your Board certifies, and if they certify, all of these other things come into place, the supervision, the pilot program, the Special Asset Council, special asset group and so on, however the district does not have to immediately agree to issue that additional stock. In other words, you can authorize them, if you certify you can authorize, you can say they are authorized to issue preferred stock to bring their stock up to 75 percent, but they do not have to accept the certification, as I understand it. Is that correct? In other words, you could certify and the receiving district could refuse or decline to accept the assistance. I believe that is the case.

Mr. THOR. Senator, I think they could decline to accept the terms and conditions. That is part of the negotiation process with the Assistance Board.

Senator BOREN. Yes. What I am thinking about is that in essence they could simply decline to issue the stock to bring them up to 75 percent of par value right now until after review of the situation by the 6th of July when they will then determine whether or not they need to issue preferred stock.

This would get you in a situation where they followed the mandate of applying for certification. You have certified them and brought them under all of the other provisions in terms of supervi-

sion, special asset group, pilot programs, and the other things, the other protections with which we are concerned. It would also leave it open that if drought or other conditions intervene to make it a worse situation, they would be eligible in this process for possibly other kinds of assistance as well, but it would prevent you from infusing cash. In other words, you could work out something between the agreements entered into or you could say you are authorized to do so after July 6 if the merger on July 6 does not sufficiently bring you up to 75 percent of value. So you are certifying and you are certifying in a way that would bring them up to 75 percent of value, but we all know that they will be after the merger, so you can say if they are not brought up to 75 percent by the merger, they are hereby authorized, since they are certified after the 6th of July to issue preferred stock, to bring them up to this level.

That way, everybody would be following the law. As I say, I do not see that this situation would recur again, because you have these mandatory mergers, so if anyone comes to you in the future, and it is a district that is below 75 percent, there is not going to be something like a merger that is going to bring them out of it, so that you would have to then deal with following the mandate to bring them up to the 75 percent level.

This might be a way, and I would just urge you to look at this as a way. That way we do not set a precedent, because what we do not want to do that. We do not want to water down the mandate to apply, and we do not want to water down the mandate to bring them up to 75 percent, plus using the other tools available as well. But, we do not want to do anything unreasonable here in terms of actually going out and issuing preferred stock when, as you say, putting an additional debt burden on the district when that district may not have to borrow that amount after the merger.

I would urge you to look at it in a way that you can handle this situation, so that it does not set the precedent of watering down the two key elements that the subcommittee was interested in when we wrote the legislation. I think there may be a way to do it that handles this unique period that we are in here. I think maybe that is something that could be worked out.

Mr. THOR. Again, Senator, we appreciate your counsel and advice on these issues. They are obviously very delicate as well as complex financial and legal issues and we will go back to the drawing board and ensure that that is the case.

Senator BOREN. What is that?

Mr. THOR. My general counsel was just here to hear it, so he will take that to heart.

Senator BOREN. Good. I do not know, maybe cornfield equity or whatever that I am urging on you, but I would urge that more action be taken.

Mr. THOR. Well, being from Nebraska, cornfield equity is not bad——

Senator BOREN. It is not all bad.

Mr. THOR [continuing]. So let us go for that.

Senator BOREN. We do not want to undermine the basic thrust of the intent of the law and I think you understand that and let me say again that I appreciate the forthright way that you do respond and the fact that you are not sitting on high center doing nothing,

you are over there moving and organizing, getting things going. I am glad we have the other member now confirmed and we appreciate your willingness to respond to us as you did in a very forthright way and always with dispatch.

What I have said today was not meant to be quarrelsome at all, but just meant to be very forthright in terms of what the subcommittee intended. We labored over this so long that we do not want now to have the law not implemented in the way that we all intended it to operate, and we have confidence that you will try to carry out the spirit of it as well as the letter of it.

Mr. THOR. Thank you, Senator.

Senator BOREN. Thank you very much.

Our next witness is Mr. Sam Eberly, Chairman of the Board of the Farm Credit Council, Wichita. He is accompanied by Mr. Brent Beesley, the CEO of the Farm Credit Corporation of America. They will be followed by a panel, and I think we will try to be as brief as we possibly can and go straight through. It probably would be good for me if I went through several lunch hours anyway, but we will try not to go on too long, in case the members begin to weaken around the table from lack of lunch.

Mr. Eberly, we would be happy to receive any opening statement from either you or Mr. Beesley. We will put your entire prepared statement in the record, if you would like to summarize the major points that you would like to make.

STATEMENT OF SAM EBERLY, CHAIRMAN OF THE BOARD, THE FARM CREDIT COUNCIL, ACCOMPANIED BY H. BRENT BEESLEY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FARM CREDIT CORPORATION OF AMERICA

Mr. EBERLY. Thank you, Mr. Chairman. It is our pleasure to be here this morning. I appreciate the Subcommittee's interest in the Farm Credit System. I would ask that both Brent Bessley's prepared statement and mine be submitted for the record.

Senator BOREN. We will receive both of them.

Mr. EBERLY. I would like to say that the System is very much aware of our obligation that we have to live up to the trust that Congress gave to us when you passed this act and has reaffirmed the position of trust in the Farm Credit System, so with that I would just like to make a few opening remarks, would kind of summarize my testimony.

I think the System has to believe that a strong and viable agricultural economy is vital to the long-term profitability of this System, and we certainly mirror that in the ag economy. As you have heard here this morning, the Midwestern States, the drought is a serious concern and we have to wait to see what will happen on that before we know where our financial recovery may be coming from.

We would like to applaud the efforts of this subcommittee to stay on top of those developments and we would like to join in that effort if it would be at all appropriate. We certainly do have an obvious concern, if the conditions do worsen. There are several issues I would like to just kind of draw your attention to today.

STOCK PROTECTION

The stock protection, it is very obvious that when the act was passed that it did mean that the System institutions are now able to retain their best quality customers and attract some new business because of the scare of the stock.

LOAN RESTRUCTURING

We look at loan restructuring, and I think the first thing we would like to say is we have taken to heart the message that Congress gave to restructure these loans. The loans that we are restructuring this year we are finding are bigger and more complex and are larger than those that were restructured last year.

Loan restructuring is a very staff-intensive process. We have estimated now in the System that a loan officer can handle four to five times more accruing loan volume than he can on those of financially distressed loans, so it does take people to work through these if they are done on a one-on-one basis.

In some of the cases, we are finding that borrowers need restructuring and we have the Farm Credit Administration and the Farmers Home Administration involved in a project. This has created some problems because the Farmers Home Administration does not have their restructuring regulations and will not have them in place until late this summer.

BORROWER RIGHTS

Now, on borrower rights—we have heard the comment made about the uniformity of the implementation of the borrower right. We would like to share with you that we have a System policy now implemented on borrower rights and we are working very hard to try to work out the differences in interpretation that we are finding that is happening at some of the local levels, and we are going to once again reexamine how we can further look at uniformity in borrower right provisions.

SYSTEM CAPITALIZATION

The capitalization—we talked about briefly here this morning on this and it is something that we are very concerned about. In the 7 percent adjusted risk assets, that nearly doubled what some of the other proposed regulations are. We certainly agree with the FCA that we need a well-capitalized institution and that we should have capital well above any minimum, but our concern that is mandating that predetermined level each year for the next 5 years is not practical if this system is going to be competitive.

We have talked about raising capital by investors. That does not appear to be a viable alternative now, given our subsistence financial condition, and there have been times when FCA has suggested that the System cut overhead to generate earnings. Well, when we cut overhead in districts where we have to look at a lot of restructuring, it is not feasible because of those large staff-intensive projects.

If permanent capital is to be accumulated through earnings, we have estimated in one district that it will cost over 3 percent just to

earn through the earnings. Railing rates is not a practical way to try to raise permanent capital, because it puts us out of a competitive environment.

The System position, I would like to state, is a minimum permanent capital, it should be no greater than 4 percent and should be implemented on a graduated basis over a period maybe even longer than 5 years. We believe that the FCA should pattern itself after other regulators and use that regulatory forbearance in recognition of the good faith efforts by the System institutions to reach that goal on a sound business basis.

TREATMENT OF LOAN LOSS RESERVES

Mr. Chairman, you have been very instrumental in the treatment of the loan loss reserves. That tax change law, as you know, was the methods for calculating the loan loss for the PCA's and the Banks for Cooperatives (BC's) in our System. It has been taken away from us. It is not a big figure, but it is $85 million, and that is $30 million to the BCA's and about $55 million to the BC's. We hope that something can be done to correct this inequity and we appreciate your efforts so that we do not have to raise the interest rates to accumulate that $85 million.

If you would like, Mr. Beesley will be here, is here to discuss or can discuss the position that the System has in any of the Jackson dealings. On the receivership, we have talked about that at long lengths here today. I would like to make two points on the Jackson situation.

JACKSON SITUATION

We continue to rely very heavily on the statements that Mr. Thor made that the Assistance Board has no intention of triggering the joint and several liability provision, and we strongly concur and hope these costs can be provided through the authorizations from the Assistance Board, rather than using the joint and several liability.

We are also hopeful that the receiver in Jackson can work with the Assistance Board and with FCA and with the System to minimize the cost of the Jackson liquidation, and thus minimize the total costs of the financial situation to all the members of our System.

TECHNICAL CORRECTIONS

The technical corrections bill, you are very much aware that the one-time assessment of stock for the Assistance Corporation may be holding up that bill. It is a serious issue in my district as well as one or two others.

I think we talked about it at the time that was issued, that some of the associations would be required to contribute a great majority of their capital and jeopardize their association liability, and that has come to pass.

Nevertheless, we continue to believe that the passage of that technical corrections legislation is important, particularly in the Sacramento District, where we have the problem of the reassess-

ment of the property taxes which is costing them about $100,000 a year.

CONCLUSION

In conclusion, Mr. Chairman, I would like to thank you, I would like to thank the members of the subcommittee for your commitment to getting us through what we had to go through, and we look forward to working in close partnership with you and all the rest of the members of the committee in implementing the act.

We will be happy to respond to any questions you might have. Thank you.

[The prepared statements of Mr. Eberly and Mr. H. Brent Beesley and attachments follow:]

THE FARM CREDIT COUNCIL
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Statement by

Sam Eberly
Chairman of the Board
The Farm Credit Council

Before

The Honorable David Boren, Chairman
Subcommittee on Credit
Committee on Agriculture, Nutrition & Forestry
United States Senate

June 16, 1988

Mr. Chairman and Members of the Subcommittee:

My name is Sam Eberly. I am from Sedgwick County, Kansas and currently serve as Chairman of the Board of The Farm Credit Council, the Farm Credit Corporation of America and the Legislative Committee of The Farm Credit Council. I am also a farmer-member of the Board of Directors of the Farm Credit Banks of Wichita. Joining me at the table today is Brent Beesley, President and Chief Executive Officer of the Farm Credit Corporation of America. Mr. Beesley has a statement which I would like to submit for the record.

Mr. Chairman, we appreciate the opportunity to testify today on the Farm Credit System's implementation of the Agricultural Credit Act of 1987.

I would like to begin by expressing our sincere appreciation to the Senate Agriculture Committee, and particularly to the Members of this Subcommittee, for their support and diligence in working toward enactment of the Agricultural Credit Act of 1987. We are very aware of our obligation to live up to the trust which Congress has reaffirmed in the borrower-owned Farm Credit System.

We think Congress has given the System the tools needed to implement a recovery plan which has three main elements: organizational streamlining, cost-cutting, and Federal financial assistance only when it is needed. Mr. Chairman, because the System must repay all financial assistance received, it continues to be the intent of the Farm Credit System to minimize Federal financial assistance. This presents all directors and managers with both their greatest challenge and greatest opportunity.

For the past three years, we have testified that a strong and viable agricultural economy is absolutely vital to the long-term profitability of the borrower-owned Farm Credit System. Today, in many Midwestern states, drought is a serious concern, particularly for those farmers and ranchers who are now just beginning to experience some financial recovery. At this time, Mr. Chairman, we do not have any further information other than what was presented to the full Committee two days ago by the

Secretary of Agriculture. Secondarily, however, we have an obvious concern that if conditions do not improve or, in fact worsen, farmers will again face further economic hardships and be unable to repay their loans. Mr. Chairman, we will continue to advocate and spotlight the need for sound agricultural policies and restored profitability for farmers.

A critical element of our business recovery is restoring the confidence of borrowers and investors. I think we are making progress in both areas, as Mr. Beesley indicates in his prepared statement. I would only add that our outreach efforts with farm organizations to exchange information have been very helpful. They recognize, as do we, that their members are our borrower-owners.

Mr. Chairman, there are several issues that I would specifically draw to your attention today. These are protection of borrower stock, loan restructuring, borrower rights, the treatment of loan loss reserves, technical corrections and System capitalization.

Stock Protection

We are pleased to note that borrower flight--from the fear of loss of B-stock--has been reduced, if not halted. The stock protection provision in last year's legislation has worked as intended. Stock protection in today's competitive environment means that many System institutions will be able to retain their best borrowers and attract new business.

We are encouraged by the action taken by the Assistance Board in

the Jackson District to redeem borrower stock. We hope this will calm borrower fears and stop any further run off of good customers from the other entities in the District.

Loan Restructuring

We've taken to heart Congress' message to restructure borrower loans. Working with distressed borrowers continues to be a major business priority of the Farm Credit System, as evidenced by the fact that loan restructurings in 1987 were nearly double those done in 1986.

While we have made progress, we are trying to do even better, realizing that there are four issues which affect the number of loans which are restructured.

1. Restructuring takes place just like loans are made: one-at-a-time. While one loan officer might have the ability to service 40-50 accounts that are on an accruing basis, that same loan officer might only be able to work with 10 borrowers experiencing financial difficulty.

2. Last year, the loans which were restructured were less complicated than those which are now being restructured. Again, the more complicated the loan, the more time it takes to be restructured.

3. There is the added problem of a borrower who needs restructuring by both Farm Credit and FmHA to be viable. FmHA

still does not have its regulations on restructuring in place and probably will not until late this summer at the very earliest. If a borrower requests restructuring, we are obligated to act on that request in an expeditious manner.

4. Staffing is also a factor. As you have heard from many constituents, loan servicing in some areas has suffered because of serious and conscientious attempts to cut operating expenses. In some banks and associations which have made 10-20 percent cuts in order to hold the line on interest rates, the pressure on staff becomes immense. We are expecting all of our staff to perform at super human levels 100 percent of the time. There is simply no way that we can do that.

Mr. Chairman, these are not excuses. They are offered here today to explain why restructurings may not proceed as quickly as all of us would like.

Borrower Rights

I would like to make just a few comments about the issue of borrower rights. For some time after passage of the 1987 legislation, we were challenged for not recognizing the rights of borrowers. Mostly, it was a question of interpretation of the law. Generally, I think there has been some improvement.

We have continued to hear some concerns expressed about the need for System uniformity in the implementation of those rights. Even though we have successfully implemented a System policy on borrower rights, we are now working to minimize any differences

in interpretation which occur at the local level. We are going to once again examine how we can further ensure uniformity. A successful resolution of this issue is essential to maintaining borrower confidence.

System Capitalization

A final issue is FCA's proposed regulation on minimum capital standards. As proposed, the regulation would require System banks and associations to maintain permanent capital at a minimum of seven percent of their risk-adjusted assets, nearly double that required for commercial banks as recently proposed by the Federal Reserve Board, the Comptroller of Currency and the Federal Deposit Insurance Corporation.

This issue is covered in detail in Mr. Beesley's statement, so my comments will be brief.

1. The Farm Credit System agrees with FCA that a well capitalized institution should have capital above any minimum prescribed by its regulator. Our concern is that mandating a predetermined level each year for the next five years is not practical if the System is to be competitive. We also disagree with FCA's proposed level of 7 percent.

2. If FCA does not modify their position, borrower loan rates will increase from one to three percentage points or more. While capital might be raised from investors, this does not appear to be a viable alternative at this time, given the System's

financial condition.

3. FCA has suggested that the System cut its overhead in order to generate earnings, and thereby eliminate the need to raise interest rates. It simply isn't feasible to cut costs in districts facing major loan restructuring efforts.

4. If the new permanent capital is accumulated through earnings, one district has estimated that the draft regulations would result in the need to increase borrower loan rates by over three percentage points. This would make System institutions uncompetitive, and may force some banks and associations out of business.

5. It is the System's position that minimum permanent capital should be no greater than 4 percent and should be implemented on a graduated basis over a period longer than five years. Further, we believe that FCA should pattern itself after other regulators and use regulatory forbearance in recognition of good faith efforts by System institutions to reach a standard on a sound business-like basis.

6. Other government "sponsored" agencies like Fannie Mae (Federal National Mortgage Association) are capitalized at lower levels than commercial banks because of limited liquidity risk and access to financial markets in a manner similar to that of Farm Credit.

7. Last, the proposed regulations for commercial banks which FCA often cites are just that, proposed. We would respectfully

suggest that these regulations are far from being implemented at the level proposed.

Treatment of Loan Loss Reserves

Mr. Chairman, another very important issue today is the significant burden which has been placed on the System because of changes in the tax law. Specifically, the reserve method for calculating loan losses for the System's Production Credit Associations (PCAs) and Banks for Cooperatives (BCs) has been eliminated. While this was taken away from the System, our competitors were allowed to retain it. Though some will argue that the cost is not that large, it is a significant cost to the PCAs and BCs who must cover the $85 million cost and still remain competitive. From the perspective of the borrower, we are very concerned that if something is not done to correct this inequity, institutions will have no alternative but to raise interest rates.

Jackson Situation

Mr. Chairman, Mr. Beesley will be discussing the System's position regarding the Jackson Federal Land Bank and FLBA Receivership in some detail. I would like to reinforce two points. We continue to rely on the statements of Mr. Thor that the Assistance Board has no intention of triggering joint and several liability. We strongly concur and hope that these costs will be provided through authorizations from the Assistance Board. We are also hopeful that the Receiver, the Assistance

Board and the FCA will continue to work with the System to minimize the cost of the Jackson liquidation, and thus, to minimize the total cost of financial assistance.

Technical Corrections

Another critical issue is passage of the Technical Corrections bill to the Agricultural Credit Act of 1987. This legislation passed the House in February, and has been held at the desk in the Senate.

We understand that the issue which is holding up the bill is the manner in which the one-time assessment of associations for Financial Assistance Corporation stock is handled. This is a serious issue in my district as well as in one or two others.

At the time this issue was considered, we indicated that some associations would be required to contribute a great majority of their capital and jeopardize their association's viability. Nevertheless, we continue to believe that passage of the Technical Corrections legislation is important.

Conclusion

I would like again to thank the Members of this Subcommittee for your demonstrated strong commitment to ensuring a cooperative provider of credit for America's farmers. We remain committed to working in close partnership with you to implement fully the Agricultural Credit Act of 1987.

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Statement of

H. Brent Beesley

President & CEO

Farm Credit Corporation of America

Before

The Honorable David L. Boren, Chairman

Subcommittee on Credit

Committee on Agriculture, Nutrition, and Forestry

Unite States Senate

June 16, 1988

Mr. Chairman and Members of the Subcommittee:

My name is Brent Beesley. I appreciate the opportunity to submit this statement for the record.

The 600,000 American farmers and ranchers who own the Farm Credit System appreciate the careful thought and diligence which the Congress, and members of this Subcommittee in particular, devoted to the consideration and passage of the Agricultural Credit Act of 1987 (the "1987 Act").

What emerged from these bipartisan efforts was not a "bailout of the Farm Credit System" as it has been termed by some, but a blueprint enabling this country's largest agricultural lender to continue to fulfill the intent of Congress to provide dependable and competitive credit to farmers and ranchers.

The 36 banks of the Farm Credit System have all had the opportunity to review this prepared statement. It addresses the following topics which relate to the implementation of the 1987 Act:

1. Financial Condition of the Farm Credit System as of March 31, 1988

2. Forecast of the Farm Credit System's Financial Condition for 1988
3. The Farm Credit System 1988 - 1989 Business Plan
4. Credit Quality
5. Loan Restructuring
6. Other Property Owned
7. Borrower Rights
8. High-Cost Debt
9. Operating Expenses
10. Loan Pricing
11. Competition
12. Consolidation Issues
13. Protection of Borrower Stock
14. Secondary Mortgage Market
15. Capitalization
16. Financial Assistance
17. Jackson Situation
18. Borrower Insurance
19. Affirmative Action
20. Tax Treatment of Loan Loss Reserves
21. Rural Development
22. Technical Corrections

1. FINANCIAL CONDITION OF THE FARM CREDIT SYSTEM AS OF MARCH 31, 1988

The Farm Credit System was created by Congress solely for the benefit of the farmers, ranchers and agricultural cooperatives of this nation. Everything done by the 14,000 employees of the System is designed for the ultimate benefit of our owner-borrowers.

Much of the 1987 Act was designed to return the Farm Credit System to profitability. Unless the System can be competitive and profitable in the long run, it will either eventually fail or need to be permanently subsidized. There really are no other alternatives. We are confident that the Farm Credit System can

best serve the country by vigorously competing as a cooperative lender which is profitable over the long term.

I would be remiss if I did not point out the obvious: the financial health of the Farm Credit System is inextricably linked to the economic health of agriculture generally. We are a mirror of the agricultural economy.

To the surprise of many agricultural economists, 1987 turned out to be a good year for many American farmers. In spite of ominous forecasts, net cash farm income rose to a record $57 billion. Several positive influences contributed to the relatively favorable results. For example, land values stopped their precipitous fall in most areas; production input costs and commodity surpluses were down; and agricultural exports and many commodity prices were above expectations.

Thanks to the salutary effects of the 1987 Act, both American agriculture and its largest lender have reason for optimism. Mr. Chairman, as you know, the System's losses in 1987 were only $17 million, compared to nearly $2.7 billion in 1985 and $1.9 billion in 1986. There were four major factors which contributed to this improvement:

1. Improving land values. Some of the increase in land values can be traced to the care which the System has taken in marketing acquired properties and by its willingness to finance the purchase of farmland at competitive prices.

2. Improving credit quality. The improvement in the credit quality of the System's loan portfolio is due, in large part, to the restructuring of 33,470 loans worth $4.5 billion during 1987. Instead of having to make additional provisions of $760 million to allowances for loan losses as expected, the System was able to reduce its allowances by $196 million and add this back to its capital base.

3. Improving confidence in the System. The passage of the 1987 Act was itself a major contributor to the System's better-than-anticipated results. Concern over the safety of borrower stock was reduced and loan volume stabilized during the second half of the 1987.

4. Improving investor confidence. This caused interest-rate spreads on Farm Credit debt obligations over U.S. Treasury securities to narrow. In rural America and on Wall Street, your efforts in crafting this legislation were viewed as a positive sign and as a statement of support for the farmer-owned Farm Credit System.

Mr. Chairman, the System's combined net income for the first quarter of 1988 was $165 million. This represents a modest turnaround from the $155 million combined net loss for the first quarter of 1987. While some improvement in net income has been realized between the two years, the first quarter of the year corresponds to an early stage in the agricultural production cycle. Mr. Chairman, we must note that the potential for a serious drought in the Midwest and other areas may have an impact

that is, as yet, largely unmeasured. Accordingly, considerable uncertainty existed at the end of the first quarter as to the annual operating results for many System borrowers and the related impact upon System banks and associations for the balance of 1988.

Nevertheless, the first quarter of 1988 was the third consecutive quarter of net income after several consecutive quarters of net losses and was consistent with the reduction in annual losses experienced by the System over the past three years. The continuing major factor in the improved results for the first quarter of 1988 was a substantial reduction in the provision for loan losses. In addition, net gains, rather than net losses, on sales of other property owned were realized during this same period. These favorable factors more than offset the impact of the continued declines in net interest income.

The table that follows illustrates the major components of the System's operations for the first quarters of 1988 and 1987, and for the past three years.

COMBINED STATEMENT OF OPERATIONS DATA
($ Millions)

	Three Months Ended March 31, (unaudited)		Year Ended December 31, (audited)		
	1988	1987	1987	1986	1985
Net interest income	$ 146	$ 149	$ 509	$ 781	$ 1,295
Provision for loan losses and losses on other property owned	170	(140)	184	(2,031)	(3,253)
Operating and miscellaneous expenses, net	(151)	(164)	(710)	(663)	(731)
Net income (loss)	$ 165	$(155)	$ (17)	$(1,913)	$(2,689)

Not only did the agricultural economy show signs of strengthening during 1987 and through the first quarter of 1988, but Farm Credit banks and associations continued programs to reduce or restructure their substantial levels of high-risk assets -- all contributing to a stronger earnings statement.

As a result of these positive factors, most System institutions experienced a stabilization or improvement in the credit quality of their loan portfolios during 1987 and through the first quarter of 1988. High-risk assets, loan delinquencies and loan losses declined from prior-year levels as borrowers' financial conditions and cash flows improved. Farmland values, which directly impact the value of collateral supporting the majority

of System loans, stabilized in most regions of the United States, further contributing to the improved financial conditions of borrowers.

The chart attached as Exhibit 1/Chart 1 shows how high-risk assets (which is one measure of credit quality of loan portfolios) have been reduced from their high of $14.3 billion at year-end 1986 to $10.7 billion at March 31, 1988.

Despite these improvements, the System continues to be burdened by high levels of non-earning assets, relatively high operating costs and accruing loan volume below historical levels. Also, net interest income remains below operating expenses.

These continuing problems are reflected in the following examples:

First, high-risk assets remain about 20 percent of loans and loan-related assets, while nonaccrual loans remain at nine percent of total loans outstanding.

As another example, net interest income continues to be less than operating expenses incurred. Two major factors contributed to this result. The first is the high level of non-earning assets.

If all non-earning assets had been earning interest, the System's net interest income would have been in excess of $900 million in 1987 and $250 million during the first quarter of 1988. In addition, working with distressed borrowers to reduce the level of non-earning assets increases the System's operating expenses. Second, in order to keep creditworthy borrowers in the System, interest rates on loans have been reduced to more competitive levels.

As a final example, as System loan volume has declined over the years, the high-cost debt of the System has become a greater percentage of total debt outstanding, placing downward pressure on net interest income.

Accruing loan volume stabilized somewhat during the first quarter of 1988. At March 31, 1988, it was $48.0 billion, as compared with $47.3 billion at year-end 1987. This stabilization in accruing loan volume is attributable, in large part, to Congressional passage of the 1987 Act. This legislation alleviated some borrowers' fears that they would lose their stock investments in System institutions. This removed the incentive for those borrowers to move their loans to non-System institutions. Another factor contributing to the stabilization of accruing loan volume is the more competitive loan pricing by System institutions.

2. FORECAST OF FARM CREDIT SYSTEM FINANCIAL CONDITION FOR 1988

Although current weather patterns may alter this forecast, System institutions generally expect the strengthening of the agricultural economy that contributed to the System's 1987 financial performance to continue into 1988. As a result, most System institutions are expecting continued improvement in the

credit quality of their loan portfolios. This may be reflected in lower expected levels of nonaccrual loans and other high-risk assets by the end of 1988.

Continued improvement in credit quality of the loan portfolios may allow many System institutions to reduce somewhat the valuation allowances that relate to their existing loan portfolios. Also, continued improvement in farmland values would contribute to minimal losses or possible gains on the disposition of other property owned.

Improvements are also expected with regard to operating expenses and other income. System institutions are committed to continuing to reduce operating expenses. When you consider the major expenses associated with the district programs to reduce their significant levels of non-earning and other high-risk assets, this is a notable goal.

Offsetting these favorable earnings trends is the expected continuing decline in net interest income. There are four factors that may contribute to this decline or at least not reverse it. First, aggressive competition by other lenders who are free to diversify their risks will force System institutions to forego normal profit margins. Second, the System is expected to continue to be burdened by high--although declining--levels of non-earning assets. Third, in spite of significant efforts to attract or retain borrowers, because of the general contraction of agricultural credit, System institutions expect that accruing loan volume may decline again later in 1988, although to a lesser extent than in prior years. Finally, as the result of the impact of declining loan volume on funding opportunities, there will be only limited relief from the high-cost debt problem that has existed in recent years.

Looking at the remainder of 1988 and future years, there are a number of issues about which System institutions are concerned. These include:

A. The ominous lack of rainfall in certain areas. The emerging drought situation could severely impact the ability of many farmers to enjoy an abundant harvest and be able to service their debt obligations. Some cooperative agribusinesses which also borrow from the System are also vulnerable to adverse weather conditions, as the demand for their products and services would be expected to decline.

B. The uncertain nature of future Federal Government farm support programs. Payments under these programs have an extremely favorable impact upon farmers' cash flows and financial positions and, as a result, upon System borrowers' abilities to repay their loans.

C. The continuing contraction of agricultural debt generally. This may lead to even more intensive

competition for creditworthy borrowers, resulting in interest rates that are lower than warranted by the credit risks inherent in the loans and in further downward pressure on the System's net interest income.

D. The continuing high levels of non-earning and other high risk assets. At 20 percent of loans and loan-related assets, high risk assets represent a significant continuing problem in a fragile economic environment.

E. The continuing level of high-cost debt. Without continued stabilization of System loan volume, our significant percentage of high-cost debt will continue to put downward pressure on the System's net interest income.

F. The need to further reduce operating expenses. System institutions recognize that operating overhead needs to be reduced further; but there is also the recognition that substantial personnel and other resources must be dedicated to working with borrowers to restructure their loans as part of an overall effort to further reduce non-earning and other high-risk assets. Moreover, further reductions in operating expenses will be offset to some extent by operating cost increases resulting from the 1987 Act; that is, premium payments to the Farm Credit System Insurance Corporation and costs incurred to repay Federal assistance received.

G. The cost of acquiring permanent capital. With the protection afforded borrower-stockholders' equities under the 1987 Act, System institutions recognize the need to recapitalize with new permanent capital, but also recognize that such capital will be attracted only at a substantial cost.

H. The cost of repaying any Federal financial assistance that is received. The cost of repaying this obligation may have a significant impact upon the pricing of loans for existing and future generations of borrowers.

3. THE FARM CREDIT SYSTEM 1988 - 1989 BUSINESS PLAN

Mr. Chairman, the System agrees with those who say that the Agricultural Credit Act of 1987 does not guarantee the survival of the System or any of its entities. Indeed, many challenges still confront our directors and employees. We recognize that we are in a very complex, rapidly changing and increasingly competitive environment. The System has a Business Plan that has been in effect since May 1986. The Plan was revised in May 1987 and again in May 1988. The 1988 update was approved by the FCCA Board of Directors, and is currently being considered by all Farm

Credit District Boards. The complete Business Plan is included in Exhibit II. In summary:

- Our stated mission is:

  The Farm Credit System will be the nation's premier provider of credit and financial services to farmers, ranchers, cooperatives and other eligible entities.

- Our strategic (longer-term) objectives are to:

  A. Be a dependable source of high-quality financial and credit-related services to all qualified customers;

  B. Price products on the basis of competition, risk incurred and cost of delivery;

  C. Maximize efficiency and effectiveness in the delivery of products and services and in the management of human and physical resources;

  D. Maximize long-term profitability to support growth, strengthen the Farm Credit System's capital base and provide a competitive return on owners' investment; and

  E. Assess, manage and control credit, interest-rate and liquidity risks.

- Our business (shorter-term) objectives are to:

  A. Work with troubled accounts to reduce non-earning assets, restructure loans when appropriate and manage acquired property effectively;

  B. Attract and retain quality customers and employees;

  C. Transform the System into a streamlined, efficient and competitive provider of credit and financial services;

  D. Implement programs to assess, manage and control interest-rate, credit, liquidity and other risks; and

  E. Build System financial strength and reputation, and maintain System independence.

Mr. Chairman, we have the strategies, policies and procedures in place to accomplish these objectives, and over the last two years substantial progress has been made in virtually every aspect of System operations.

To assist the System in monitoring its operational progress, a set of measures which we call "Key Indicators" was developed. Those indicators are included as an appendix to the System Business Plan. Of course, continued improvement is still and always will be desired. It is up to every director and employee to see that the System Business Plan is implemented and that we get the job done right for those who depend on the System.

4. CREDIT QUALITY

Mr. Chairman, the quality of the System's loan portfolio continues to improve as can be seen from the following charts that are included in Exhibit 1:

Credit Quality Comparison - The chart attached as Exhibit 1/Chart 2 compares the percentage of total loans classified as "acceptable" ("acceptable and other assets especially mentioned" in 1987) to total loans for the years 1986, 1987 and for the first quarter of 1988 for each of the three groups of banks.

As might be expected, FICB/PCA loans (representing the short-term credit portfolio) have shown the greatest improvement in credit quality from 59.0 percent to 73.5 percent. The FLB/FLBA and CBC/BC bank groups are also showing improvement, but at a slower pace.

Components of Net Loans - The chart attached as Exhibit 1/Chart 3 shows the levels and relationships of accrual loans, nonaccrual loans and the allowance for losses. Accrual loan volume stabilized in the first quarter of 1988. nonaccrual loan volume reached a high in 1986 and declined significantly in 1987 and again during the first quarter of 1988. The combined allowance for losses was reduced accordingly.

High-Risk Loans - The chart attached as Exhibit 1/Chart 4 shows the amount and relationship of high risk loans in both accrual and nonaccrual accounts. It clearly shows the rapid increase in high-risk loans from December 31, 1984, to December 31, 1986, and the reduction during 1987 and for the first quarter of 1988 for both the accruing and nonaccrual portfolios.

Loans 90 Days or More Past Due - The chart attached as Exhibit 1/Chart 5 reflects the high percentage of loans due at year-end and how delinquent loans are worked out, converted or collected during the year. The delinquency pattern for 1987 shows improvement over 1986.

The improvement shown in these charts is attributable to the positive factors which have contributed to improvement in the cash flows and financial positions of most farmers in 1987. The resulting improvement in cash flows and debt-to-equity positions of System borrowers had a direct positive impact on the credit quality of the loans at the System's banks and associations. Continuation of these positive trends is dependent in large part on continuation of the U.S. Government farm programs.

We remain concerned about the financial health of those farmers and ranchers who have high levels of debt and who did not seem to be participating in the increased income levels enjoyed by most other farmers and ranchers in 1986 and 1987. According to USDA figures, almost one-third of all farmers are classified in this vulnerable category.

5. LOAN RESTRUCTURING

The System is proud of the record it has established during the last two years in the area of loan restructuring. Having had only occasional problems with loan defaults during the previous several decades, the System was not well-equipped in the mid-1980s to handle the over 100,000 borrowers who were unable to make their payments as agreed. Since July 1986, the Farm Credit System has restructured over 50,000 loans. The word "restructuring" has not always been clearly defined and has been used to refer to a variety of methods of working with financially troubled borrowers. The chart attached as Exhibit 1/Chart 6 has the various categories of loan restructuring listed separately.

The restructuring information indicates that most of the System was carrying out the intent of the Agricultural Credit Act of 1987 well before its enactment. In the last two plus years, the Farm Credit System has taken restructuring actions on 55,625 loans: 17,544 loans in 1986; 33,470 in 1987; and in the first quarter of 1988, 4,601 loans. (See Charts 7, and 8 of Exhibit 1.)

I submit that the numbers shown above clearly portray a System that is working hard with its members who are having financial difficulty.

Mr. Chairman, in some parts of the country, FCA is requiring restructured loans to meet the same basic standards relating to eligibility and scope of financing, loan terms and conditions, and security requirements applicable to new loans. This position is making it more difficult to restructure problem loans. The System believes that banks and associations must have maximum flexibility to work with troubled borrowers.

6. OTHER PROPERTY OWNED

Mr. Chairman, other property owned declined significantly in 1987 and again declined in the first quarter of 1988. The chart attached as Exhibit 1/Chart 9 shows that the balance peaked in March, 1987, and had declined below 1985 levels by year-end 1987.

Every effort has been made to return the property acquired by the System, either through voluntary or involuntary means, back into the hands of private parties in a manner which does not depress land values.

In some cases, land has been sold in a manner which actually builds confidence and appears to have increased land values. The most visible example of this is the St. Paul District. Its willingness to provide a guarantee of the value of the land sold

seems to have played a part in reversing the downward trend of land values in that area. Land values in the St. Paul District increased by approximately five percent between June 17, 1987, when the program was announced and December 31, 1987. Though nearly half of the buyers chose not to accept the guarantee, simply offering the guarantee increased borrower confidence in the value of farmland.

7. BORROWER RIGHTS

Mr. Chairman, many of the borrower rights and loan restructuring provisions of the Agricultural Credit Act of 1987 were already in place in many Farm Credit districts even before the enactment of Title I of the 1987 Act. Nevertheless, the System took very seriously the charge which you gave us in the 1987 Act, and the results of the System's efforts to date are something in which both the System and the Congress can justly take pride.

Immediately upon enactment of the 1987 Act, work groups of System attorneys and credit professionals began work developing a Model Distressed Loan Restructuring Policy in conformity with the new requirements of Title I. With relatively few modifications, this model policy was adopted by the boards of directors of the twelve Farm Credit districts within 60 days of enactment of the Act.

These System work groups also developed a series of guidelines and procedures designed to promote the greatest degree of uniformity possible in the interpretation and application of the newly created statutory rights and requirements in Title I of the Act. I am pleased to report that the System is generally achieving a high degree of uniformity in the application of the borrower rights and loan restructuring provisions of the Act. As Mr. Eberly pointed out in his statement, there continue to be a few local problems which must be resolved. With few exceptions, a borrower in one Farm Credit district will experience the same courteous, cooperative, and consistent approach to borrower rights and loan restructuring that a borrower in any other Farm Credit district will receive.

In implementing the borrower rights provisions of the Act, we had two primary objectives: (1) to reach beyond the literal requirements of the statute and embrace the spirit and intent of Congress underlying the statutory language of Title I; and (2) where alternative ways of achieving that Congressional intent exist, to adopt the approach that is least costly to the System and ultimately to the taxpayer without deviating from Congressional intent. The early returns strongly suggest that the System has been faithful to both of these principles.

Whether it be loan restructuring, right-of-first-refusal or one of the other borrower rights created by the Agricultural Credit Act of 1987, borrowers and former borrowers of System institutions have found a more cooperative and more consistent approach toward dealing with their common problems as a result of these System efforts.

8. HIGH-COST DEBT

Mr. Chairman, the System continues to be burdened by approximately $21 billion in high-cost debt as reflected in the following table.

Systemwide Bonds at Year-End 1987

Maturing In	Weighted Average Interest Rate	Amount (in Millions)
1989	10.88%	$7,359
1990	11.17%	5,090
1991	11.00%	3,987
1992	13.20%	1,198
1993 and after	11.64%	3,772

The amount of this debt is decreasing as the high-cost bonds mature and are refinanced. The decline in loan volume over the last several years has unfortunately resulted in the high-cost debt becoming an increasing percentage of the remaining overall debt portfolio. At the end of 1987, high-cost debt constituted about 40 percent of Systemwide bonds and notes. If loan volume has indeed stabilized, then the declining amount of high-cost debt will represent a decreasing percentage of the System's overall debt. In that case, the System's average cost of funds may decline even more than it has in recent years.

9. OPERATING EXPENSES

Mr. Chairman, as loan volume has declined in recent years, System institutions have made significant progress in reducing their operating overhead. Their efforts have included reducing employee levels, merging associations, realigning or downsizing bank and association operations, and implementing other cost reduction measures. However, the beneficial impact of these programs has been offset to a great degree by the additional personnel and other costs incurred by the Federal Land Banks and Associations to initiate programs to work with financially stressed borrowers to reduce the significant levels of non-earning and other high-risk assets. In 1987, operating expense reductions were also tempered because additional provisions were made for planned further realignments and/or downsizing in certain districts. The chart attached as Exhibit 1/Chart 10 shows the operating expense reductions that have occurred in recent years.

System institutions remain committed to reducing operating expenses in 1988 to the extent such reductions do not negatively impact their ability to work with financially stressed borrowers. Beyond 1988, the capability of System institutions to further reduce operating expenses will be offset to some extent by costs resulting from the 1987 Act; that is, insurance premiums to be paid to the Farm Credit System Insurance Corporation and the cost of repaying any financial assistance received.

10. LOAN PRICING

Mr. Chairman, during much of the last several years, the System was criticized for charging above-market loan rates. After a hard-fought battle with the Farm Credit Administration, the System was given the authority to set its own rates through passage of the Farm Credit Act Amendments of 1986. In most cases, this authority has been used responsibly.

Our pricing policy continues to be as follows:

> Each district has the authority to set interest rates and has the responsibility to administer interest-rate programs in a businesslike manner, provided certain minimum standards are achieved. Loans will be priced on a locally competitive and differential basis considering risk and costs incurred. A higher rate will be charged if local competitive conditions allow or if special costs of delivery are incurred as each bank or association deems appropriate.
>
> The Farm Credit System should price its products in the same manner as all rational business entities so as to maximize profit or minimize losses. This will accrue to the ultimate benefit of its members through a viable Farm Credit System and patronage dividends. Further, this will eliminate disruptions caused by irrational pricing strategies, i.e., pricing above or below competitive levels.
>
> The Farm Credit System will not price products in a manner which causes the System to take a loss on new loans at the margin.

Beginning with the first quarter of 1988 and quarterly thereafter, district banks are reporting interest rates for selected loan products and repricing frequencies to the Farm Credit Corporation of America. Interest rate information will be reported using the following definitions:

Effective Interest Rates. Farm Credit System interest rates will be reported as effective rates (or the rate the customer would pay for the term of the loan, taking into consideration stock requirements and/or points and fees if any) at quarter end. Effective rates are to be reported as district averages.

Interest Rate Categories. If available, Farm Credit System interest rates are to be reported in three categories. The categories are defined as:

> Lowest -- The effective rate charged the preferred or financially strongest customer.
>
> Average -- The effective rate charged a customer with an average size loan of average risk and complexity.

Highest -- The effective rate charged customers who represent the most risk or highest servicing cost (not to include rates for restructured loans).

Loan Term. Loan term is defined as the time from loan inception to the maturity of the note. Effective interest rates should be reported for the appropriate and corresponding term and repricing frequency.

Repricing Frequency. Repricing frequency indicates how often a loan can be repriced within the loan term. For example, if a 15-year loan could be repriced annually, it would be reported in the one to 36-month repricing category.

Because the reported rates are averages, individual associations may be quoting lower or higher rates in some or all categories. These rates, however, do not prevent associations or district banks from negotiating interest rates on loans to individual borrowers, on a profitable basis, to gain or retain the borrower's business.

Charts 1 through 4 of Exhibit III are charts comparing prices of selected System's loan products as of December 31, 1987, and March 31, 1988 (adjusted for the stock purchase requirement), to its average cost of funds and its marginal cost of funds. Also contained in Exhibit III is other detailed data about the interest rates charged by each district for December 31, 1987, and March 31, 1988.

Mr. Chairman, the cries and concerns of other lenders who are now having to compete with the Farm Credit System should be music to the ears of this Subcommittee. First, it means that farmers are getting better interest rates. Second, to the extent the System is able to regain its former position in the market, this will reduce the amount of financial assistance that may be required to assist the System.

11. COMPETITION

The concerns of many commercial bankers about the System's competitive position should be taken in context. During the last several years many commercial bankers and other lenders exploited the financial distress of the System to increase their customer base. Member-borrowers of the System were often warned by their friendly bankers of the many risks and dangers of owning stock in the System. When the System's rates were held far above the market by FCA prior to passage of the 1986 Amendments, there was little said by these other lenders as they lured away tens of thousands of our best borrowers.

As you know, Mr. Chairman, the Congress has recently given commercial banks many new authorities. With these new powers, with a federal guarantee for most of their debts in the form of deposit insurance and with the ability to take demand deposits, none of which the System enjoys, we find it hard to take seriously complaints of those bankers and their Washington

representatives who argue that the System somehow has a competitive advantage. For a long time to come, we hope you will continue to hear complaints from bankers and other lenders about the System being an aggressive competitor. Further, we hope FCA will avoid the temptation to get back in the business of loan pricing. We must never again be forced by FCA to keep our rates above competitive levels as happened prior to the 1986 Amendments.

12. CONSOLIDATION ISSUES

Mr. Chairman, immediately after the Agricultural Credit Act of 1987 was enacted, the System initiated several projects to implement the restructuring provisions of Title IV.

Banks for Cooperatives Structure

The Special Committee on BC Structure was formed on January 15, 1988, within the 15-day limit prescribed by law. On March 18, 1988, the prospectus for the merger vote required by the law was approved by the Special Committee on BC Structure. On March 21, 1988, that plan was submitted to FCA, again within the statutory time frame. The effective date for the consolidation--depending on the stockholder vote on June 30, 1989--is January 1, 1989.

Mandatory FLB/FICB Merger

On January 15, 1988, a work group of System officers supported by outside professional resources was formed to develop a model plan for FLB/FICB mandatory mergers. That group delivered its preliminary recommendations on February 8, 1988, and completed the Model Merger Plan and Model Merger Documents during the first week of March. The Model Plan included recommendations on several key merger issues where uniformity among the districts is considered important. It also included Model Merger Documents for use by each district.

The work group approach not only saved System banks hundreds of thousands of dollars and countless hours of time, but it will hopefully result in a high degree of uniformity in merger plans and resulting corporate structures. This should expedite FCA approval and any future consolidations of districts.

FLBA/PCA Merger Votes

With respect to mandatory merger votes by shareholders of FLBAs and PCAs sharing substantially the same territory, a similar work group approach was used to develop recommendations and model documents. The work group was established in February. It consists of both bank and association representatives and has identified a number of issues that are critical to the effective implementation of this provision of the 1987 Act. Model merger documents have also been developed.

Since many aspects of these mergers will be affected by the Capital Adequacy Regulations which will not be final for several months, final FLBA/PCA merger plans will not be completed until this fall.

In addition to the mandatory votes required by Section 411 of the Agricultural Credit Act of 1987, we expect that shareholders in several Districts will choose to hold voluntary votes on association mergers to achieve improved customer service and financial and operating benefits.

District Consolidation Vote

The Special Committee on district consolidations has been organized and held its first official meeting on June 3, 1988. The Special Committee is now in the process of developing its recommendations. Several districts are currently discussing the possibility of consolidation as part of their strategies to maintain financial viability and to avoid or minimize the need for financial assistance. The Special Committee plans to coordinate its work with all such initiatives.

13. PROTECTION OF BORROWER STOCK

Protecting the stock investment that System borrowers have in their Farm Credit institution is critical to the System's recovery. Of the System's $5.0 billion in total capital at year-end 1987, $3.7 billion was borrower stock and participation certificates. Without stock protection many System institutions would not be able to retain quality borrowers and attract new business.

Mr. Chairman, I am pleased to report that, thanks to the 1986 and 1987 Farm Credit legislation, all borrower-held stock and allocated equities are being retired at par value. I hope the farmers and ranchers of this nation appreciate what the Congress has done for them in this regard.

The 1987 Act enabled System institutions to retire stock at par value in six Production Credit Associations liquidated in 1984. Four of these associations were in the Spokane District and two were in the Omaha District. As the receivers for these liquidated associations, the Federal Intermediate Credit Banks of Omaha and Spokane applied to the Assistance Board immediately following the enactment of the Agricultural Credit Act of 1987 for assistance on behalf of the member-stockholders of these associations. Subsequently, the Assistance Board negotiated the necessary agreements and provided for $20.6 million to retire this stock at full par value. These funds have already been passed on to nearly 4,000 association stockholders, sending a strong signal to System borrowers that the stock-protection provisions of the 1987 Act have worked.

Mr. Chairman, the Association president who now serves the territory of one of these liquidated PCAs summarized the significance of this assistance best. He said, "Over the past two years, we have made tremendous progress in reducing loan risk and non-earning assets. We are offering many new loan programs at competitive rates along with a variety of new interest-rate options. A remaining obstacle has been a concern about member stock. This latest action should go a long way toward alleviating that concern."

14. SECONDARY MORTGAGE MARKET

The Farm Credit System has established a Secondary Mortgage Market Advisory Committee comprised of both directors and presidents to develop recommendations for the System entities to consider as they implement Title VII of the Agricultural Credit Act of 1987. I serve as one of the six members on this Advisory Committee.

The Advisory Committee has made several recommendations to the System, including the following:

A. That each District offer to its existing and potential members those products which are likely to be securitized through the new secondary mortgage market.

B. That each bank, acting individually or collectively, seek certification as a Certified Facility in accordance with applicable provisions of the 1987 Act.

C. That the System invest $10,000,000 in the initial issue of Farmer Mac Stock.

These recommendations are currently being considered by directors and management teams around the System.

The President has appointed the nine members of the interim board of the Federal Agricultural Mortgage Corporation (Farmer Mac). The interim board is holding its first meeting this afternoon.

15. CAPITALIZATION

Mr. Chairman, the proposed capital adequacy regulations would require System banks and associations to maintain permanent capital at a minimum of seven percent of their risk-adjusted assets. Based upon current loan volume, this means that System institutions would be required to add over $3.0 billion in new permanent capital between now and year-end 1992, an average of over $650 million each year during the next four and one-half years.

While System institutions recognize the need for permanent capital to protect against such risks as liquidity risk, credit risk, interest-rate risk and payment-system risk, the System is extremely concerned about certain of the proposed regulations.

As written, the proposed regulations would require minimum permanent capital well in excess of that required of other agricultural lenders. For example, on March 15, 1988, the FDIC, the Comptroller of the Currency and the Federal Reserve Board jointly proposed Interagency Guidelines that would require all commercial banks in the United States to maintain "core capital" of four percent. This four percent capital standard corresponds

to FCA's seven percent permanent capital standard. This is only one of several significant inconsistencies that exist between the Interagency Guidelines and FCA's proposed regulations.

Based upon a comparison of the proposed FCA regulations with the Interagency Guidelines of the other Federal banking regulators, System institutions would have to maintain in the aggregate more than $1.6 billion more permanent capital than they would if they were subject to the other regulators' capital adequacy standards. On the basis of current accruing loan volume, many System borrowers could see their loan rates increase by 75 to 125 basis points to pay for such excess capital, depending upon whether permanent capital is built by selling stock to borrowers or other parties in the financial markets--an opportunity not available to most System institutions in the short-term--or through retaining earnings of the institution. In some instances, System institutions would be pressured to raise interest rates even further to pay for such excess capital.

In support of its higher proposed capital levels, the FCA argues "... that concentrated single-industry lending within limited geographical areas is inherently riskier than is the more diversified multi-industry lending that is typical of many commercial banks."

While this single-industry argument has merit, it is offset to some extent by the fact that the agricultural industry is an extremely diversified industry having a broad variety of products, market factors and economic conditions. This diversification within the industry alleviates the need for a capital level higher than commercial banks, and certainly argues strongly against a capital level almost twice that required of System competitors. Moreover, the other Federal banking regulators in their recently proposed Interagency Guidelines did not consider it necessary to require higher capital levels for rural banks that are effectively single-industry lenders in an agricultural environment, just as much as are System institutions.

There are several other substantive reasons why a lower capital standard is appropriate for System institutions:

1. Congress, by its recent passage of the Agricultural Credit Act of 1987, reaffirmed its intention that the System be a "sponsored" organization and thereby be afforded financial market access that is not available to commercial banks.

2. The joint and several liability of System banks on System debt issues affords debt holders protection that does not exist for commercial banks.

3. The Federal Reserve can buy System debt issues in its open market operations and, thereby, provide System institutions with a source of liquidity not available to commercial banks.

4. There is an active secondary market for System debt issues which may not be available for commercial banks, thereby enhancing the marketability of debt issues and lessening the liquidity risk normally inherent in the commercial banking sector.

5. Other "sponsored" agencies, such as the Federal National Mortgage Association (Fannie Mae), are capitalized at lesser rates than commercial banks because they have limited liquidity risk; that is, they have access to the financial markets similar to that afforded System institutions. For example, on a risk-adjusted basis similar to that proposed by the FCA, as of December 31, 1987, Fannie Mae's capital was 2.0 percent of risk-adjusted assets.

6. The liquidity needs of commercial banks are inherently greater than those of System institutions by reason of the demand nature of certain commercial bank deposit instruments such as NOW accounts, savings accounts and demand deposit accounts.

7. There exists a greater need for capital in commercial banks due to the country risk taken on by many Federal Reserve Bank member banks, whereas non-BC System institutions have virtually no country risk, and in the case of the BC system this limited risk is by virtue of trade transaction financing.

8. The commercial banking sector has more payment-risk than System institutions.

9. Of the loans outstanding, System institutions as a whole have a greater percentage of collateralized loans than do commercial banks.

10. In the near future, the assets of the Farm Credit System Insurance Corporation will provide greater protection for "insured" System liabilities than do Federal Deposit Insurance Corporation assets for insured commercial bank deposits.

As an additional argument for a lower minimum permanent capital standard, the higher the standard, the more likely it will be that System institutions will need to request certification from the Assistance Board to receive Federal financial assistance. This is inconsistent with the System's position of minimizing the amount of Federal financial assistance received, and, we consider, also inconsistent with the Congressional intent underlying the 1987 Act. The FCA has stated that it believes "...the FCA (has) an obligation to minimize the reliance on Federal assistance;" but we fail to see how this stated position is consistent with requiring System institutions to accumulate excessive levels of new permanent capital in the short-term.

Based upon the foregoing arguments, we consider a minimum

permanent capital adequacy standard not to exceed four percent is appropriate for System banks and associations.

Another concern that exists with the proposed regulations is that the FCA, through its enforcement powers during the five-year phase-in period and its requirements for detailed operating and strategic plans and budgets, may become more involved in the operating decisions of System institutions well beyond what Congress intended or what is appropriate for an arm's-length regulator.

Last week, System representatives testified at the FCA hearings on capital adequacy, expressing these concerns and many others in oral and written testimony. We remain hopeful that the FCA will seriously reconsider the proposed regulations and their potential impact upon the loan rates of borrowers and the competitive position of System institutions.

One issue which was raised by the FCA Board at the hearing was that the System can tighten its belt and reduce operating costs, and thereby eliminate the need to raise interest rates to generate capital. We pointed out to FCA then and are pleased to testify today that while some reductions in operating costs have been possible, as we indicated earlier in this testimony, further reductions are unlikely in the short-term. The major reasons for this are the repayment of Federal assistance, System contributions to the Insurance Fund starting in 1989, any System costs in conjunction with the liquidation of the Jackson FLB and higher personnel costs associated with loan restructuring efforts for the next several years.

We are also concerned, Mr. Chairman, that we are now within four months of the time prescribed by the Act as a date when System institutions must have new capitalization plans in place. Given the serious issues which the System has raised regarding the FCA proposal, the extensive comments which FCA must analyze, and FCA's timetable for implementing a final rule, there will be little time for institutions to develop and adopt new plans.

When the final regulations are issued later this year, we sincerely hope that there will be a level playing field with regard to capital adequacy. If there is not, the long-term financial viability of the Farm Credit System may be in doubt.

16. FINANCIAL ASSISTANCE

Mr. Chairman, the System's position remains to minimize the amount of Federal financial assistance which may be required by running our operations as efficiently as possible. The agricultural economy will be the dominant influence on how much Federal financial assistance will eventually be needed by System institutions. Another significant influence will be the approach that the Farm Credit System Assistance Board takes in dealing with financially stressed System institutions. In my view, the Assistance Board has approached its difficult assignments to date in a professional manner. While acting independently, the Board and its staff have solicited the System's views. We are appreciative of this cooperative working relationship because, as

you well know Mr. Chairman, the System is responsible for the repayment of every dollar of assistance authorized by the Assistance Board.

The Assistance Board has taken various actions since the enactment of the 1987 Act, including the following:

On January 21, 1988, the Capital Corporation was dissolved and all of its commitments and liabilities were assumed by the Assistance Board. The 1987 Act required the Assistance Board to retire all debt and equity obligations of the Capital Corporation at book value. On February 5, 1988, the Assistance Board returned substantially all funds to System institutions which had been paid to the Capital Corporation under its assessment program. Certain amounts were retained by the Assistance Board to cover additional costs and certain litigation still pending against the Capital Corporation.

During the first quarter of 1988, the Assistance Board certified six PCAs in liquidation in the Spokane and Omaha districts to receive $20.6 million of assistance in order to permit the retirement of previously frozen borrower stock at par value in accordance with the provisions of the 1987 Act.

In February 1988, the Assistance Board authorized assistance to the FLB of Jackson, in the form of an equity investment totaling $25 million by the Financial Assistance Corporation, to allow the FLB to continue to access the debt market. In early May, an additional $5 million of similar assistance was provided to the FLB of Jackson for the same purpose. In late May the Assistance Board requested that FCA appoint a receiver.

On May 20, 1988, the Assistance Board authorized assistance to the FLB of Louisville in the form of equity investments by the Financial Assistance Corporation totaling up to $90 million prior to September 30, 1992. The Assistance Board authorized this assistance in order to allow the FLB to implement a plan, agreed on by the FLB and the Assistance Board, intended to resolve the FLB's financial problems and improve its operating results.

The Assistance Board has reported that two other FLBs and one PCA have requested certification. These requests are pending at this time.

Although the total funds that may be provided to System institutions may be less than the $2.8 billion authorized this year and the additional $1.2 billion potentially available in the future, it is critical that the financial assistance "safety net" is in place. The agricultural economy is still fragile, and whatever strength is present now may not continue in the future. Our farmers, ranchers and their cooperatives depend upon a strong agricultural economy so that they can continue in operation and service their debts.

Without that strong economy, it is important that the availability of financial assistance be present so that the System can work with financially-stressed borrowers during difficult times and be a dependable source of competitively

priced agricultural credit at all times. For this, we sincerely appreciate the efforts that were invested by all the members of the Subcommittee during the process of enacting the Agricultural Credit Act of 1987.

17. JACKSON SITUATION

On May 20, 1988, the FCA appointed a receiver for the FLB of Jackson and its related FLBA for the purpose of carrying out the liquidation of such institutions. The FCA took this action at the request of the Assistance Board. Any maturing Systemwide debt obligations on which the FLB of Jackson is primarily liable, but which it is unable to repay, are to be repaid through mechanisms (including the possible triggering of joint and several liability) provided in the Farm Credit Act. The FCA's order to the receiver provides that the outstanding equities of borrowers of the FLB of Jackson are to be retired at par value as required by the 1987 Act. The Assistance Board has certified the FLB of Jackson for limited financial assistance to enable its FLBA to retire at par, in accordance with the requirements of the 1987 Act, stock that is presently due to be retired.

The FLBs of Columbia and Texas have agreed to provide on an interim basis long-term lending service in separate areas that together constitute the FLB of Jackson's chartered territory.

The other System banks are very concerned about how the situation with the FLB of Jackson will be finally resolved. It is clear that there will be a substantial cost incurred in liquidating that institution and its related FLBA. There are two basic methods through which that cost (which ultimately becomes a cost to other System institutions and their borrowers) can be funded: by triggering joint and several liability or through the Assistance Board authorizing assistance, which is also eventually repayable by the other System banks.

In our view, the triggering of joint and several liability is not a viable option. To do so would place too great a burden upon many System banks that are already weak and have other financial burdens to bear, such as accumulating new permanent capital. To fund the cost of the liquidation of the Jackson FLB/FLBA through assistance authorizations from the Assistance Board is the only practical alternative.

To evidence their concern regarding the Jackson situation, on May 23, 1988, System representatives met with the receiver to confirm their interest in assisting the receiver to achieve a least-cost liquidation strategy.

We are hopeful that the receiver, the Assistance Board and the FCA will remain committed to working with the System in minimizing the cost of the Jackson liquidation, and thereby, minimizing the cost of financial assistance that may be required directly or indirectly.

18. BORROWER INSURANCE

Within weeks of the passage of the Agricultural Credit Act of 1987, a System work group developed uniform implementation procedures providing for:

A. Bank approval of three or more insurers based on reasonable financial and quality of service standards and compliance with state licensing laws.

B. The offering of at least two insurance carriers for each line of insurance made available by an association or bank.

C. Existing coverage to remain in place unless the borrower applies for an increased loan amount, a new loan, or an extension to an existing loan, or unless the borrower must reapply for coverage.

D. Notification to borrowers of the additional insurers and of the opportunity to request new coverage for an existing loan.

The recommended procedures have been approved by the System's Credit and Operations Committee and have been provided to each district for implementation.

19. AFFIRMATIVE ACTION

The Board of Directors of the Farm Credit Corporation of America has endorsed a model Affirmative Action Plan that can be adopted by each System entity with more than 20 employees, as required by the 1987 Act. This plan was developed by a task force of System human resources and legal experts.

System boards of directors of all applicable System entities will begin consideration of the model program this summer so that districts can begin work-force analysis and develop their goals and timetables. In addition, the System is exploring the joint purchase of equal employment opportunity training programs and materials for Equal Employment Opportunity officers, personnel specialists and supervisors.

20. TAX TREATMENT OF LOAN LOSS RESERVES

The Tax Reform Act of 1986 resulted in the repeal of the reserve method of calculating loan losses for the System's Production Credit Associations (PCAs) and Banks for Cooperatives (BCs), while the System's competitors were allowed to retain the reserve method. The cost of this change in the law to our member-borrowers is $85 million over four years.

It is our sincere hope that the interest and support which the Agriculture Committee has shown in this issue will help restore the reserve method of calculating loan losses.

21. RURAL DEVELOPMENT

Currently, the Senate Agriculture Committee is considering ways to aid in the economic development of rural America. In endeavoring to stimulate the growth of non-urban businesses, the Committee last week gave tentative approval to the creation of a rural development commission to evaluate current Federal programs; a grants program involving financial assistance for local technical assistance groups; and another grants program for rural school districts which wish to purchase telecommunications equipment.

In these discussions, several Members have expressed interest in expanding the lending authority of the Farm Credit System to include non-agricultural business loans under certain circumstances. The System would be pleased to work with the Congress in exploring these issues.

22. TECHNICAL CORRECTIONS

Mr. Chairman, as you know, The Agricultural Credit Technical Corrections Act of 1988 (H.R. 3980) which was passed by the House of Representatives on February 23, 1988, has not been acted upon by the Senate, though it has been on the Senate calendar since February 25.

The Technical Corrections legislation is important because it: 1) corrects provisions in Public Law 100-233 which currently do not reflect the agreements which the House and Senate reached in Conference; and 2) corrects drafting errors and erroneous cross references.

We sincerely hope that the Senate will pass this legislation soon.

CONCLUSION

Mr. Chairman, again may we express our deep appreciation for the concern shown by you and this Subcommittee for the credit needs of America's farmers, ranchers and their cooperatives. The System desires to work with this Subcommittee, FCA, the new Assistance Board and all interested parties to insure that the Agricultural Credit Act of 1987 is implemented as you intended.

Again, thank you for this opportunity to file this statement.

Attachments follow:

Exhibit I

Chart 1	High Risk Assets
Chart 2	Credit Quality Comparison Percent Acceptable Loans to Total Loans
Chart 3	Components of Net Loans at Year-End
Chart 4	High Risk Loans
Chart 5	Loans 90 Days or More Past Due and Still Accruing Interest
Chart 6	Composition of Restructuring Actions
Chart 7	Number of Loans Restructured
Chart 8	Volume of Loans Restructured
Chart 9	Other Property Owned
Chart 10	Operating Expenses

Exhibit II

The Farm Credit System Business Plan 1988-1989

Exhibit III

Chart 1	Farm Credit System Rate Comparisons Long-Term Loans 4th Quarter 1987
Chart 2	Farm Credit System Rate Comparisons Long Term Loans 1st Quarter 1988
Chart 3	Farm Credit System Rate Comparisons Short Term Loans 4th Quarter 1987
Chart 4	Farm Credit System Rate Comparisons Short Term Loans 1st Quarter 1988

EXHIBIT I - CHART 1

EXHIBIT I - CHART 2

CREDIT QUALITY COMPARISON
PERCENT ACCEPTABLE LOANS TO TOTAL LOANS

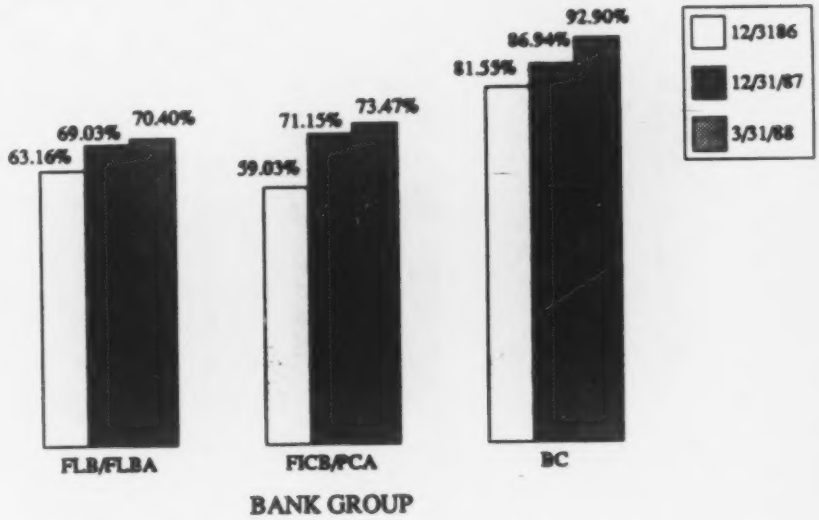


EXHIBIT I - CHART 3

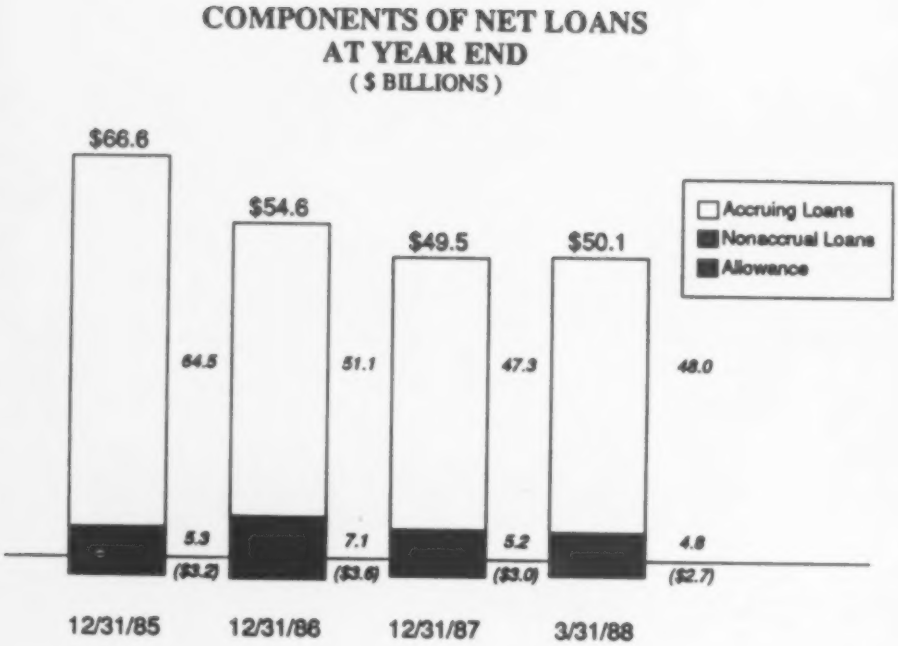


EXHIBIT I - CHART 4

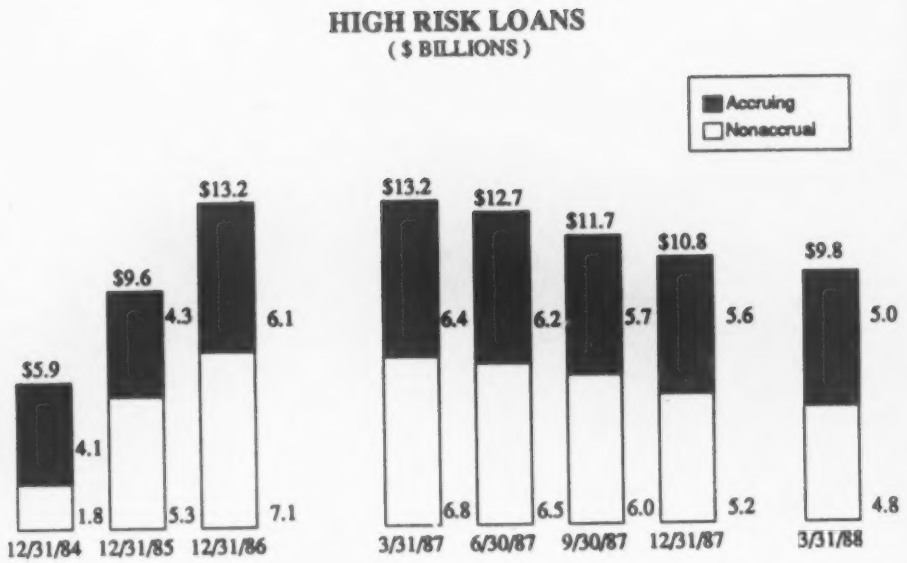


EXHIBIT I - CHART 5

LOANS 90 DAYS OR MORE PAST DUE AND STILL ACCRUING INTEREST
($ BILLIONS)

EXHIBIT 1 - CHART 6

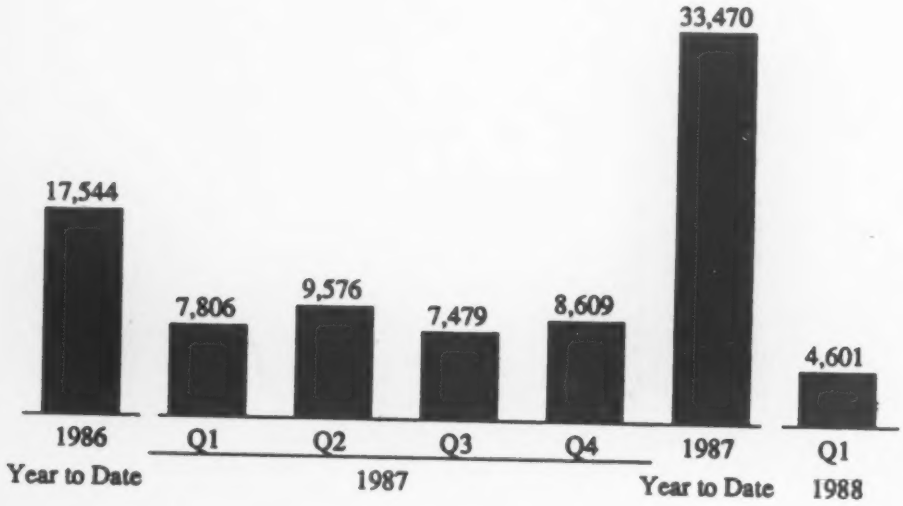
Composition of Restructuring Actions

	Q1 1987	Q2 1987	Q3 1987	Q4 1987	1987 Total	Q1 1988
Number of Loans						
Deed in Lieu-Compromise	890	1,017	1,013	1,336	4,256	283
Cash-Compromise	1,005	1,352	597	1,087	4,041	223
Other Compromises	9	6	7	10	32	398
Continuing-Monetary Concession	611	2,274	2,786	3,311	8,982	1,967
Continuing-NonMonetary Concession	5,291	4,927	3,076	2,865	16,159	1,730
Totals	7,806	9,576	7,479	8,609	33,470	4,601 *
Dollars in Thousands						
Deed in Lieu-Compromise	$132,947	$160,703	$123,406	$194,386	$611,442	$46,303
Cash-Compromise	$91,233	$151,072	$64,858	$115,382	$422,545	$23,974
Other Compromises	$647	$358	$678	$5,632	$7,315	$47,634
Continuing-Monetary Concession	$129,848	$377,953	$491,585	$456,677	$1,456,063	$615,834
Continuing-NonMonetary Concession	$654,095	$661,518	$333,033	$377,422	$2,026,068	$280,001
Totals	$1,008,770	$1,351,604	$1,013,560	$1,149,499	$4,523,433	$1,013,746 *

*As of 2/29/88 the System estimated 5,101 loans had been restructured in 1988, representing $710 million in loan balances. As of quarter end, when more exact data was available from each district's accounting systems, 4,601 loans representing $1,014 million were actually restructured.

EXHIBIT I - CHART 7

NUMBER OF LOANS RESTRUCTURED

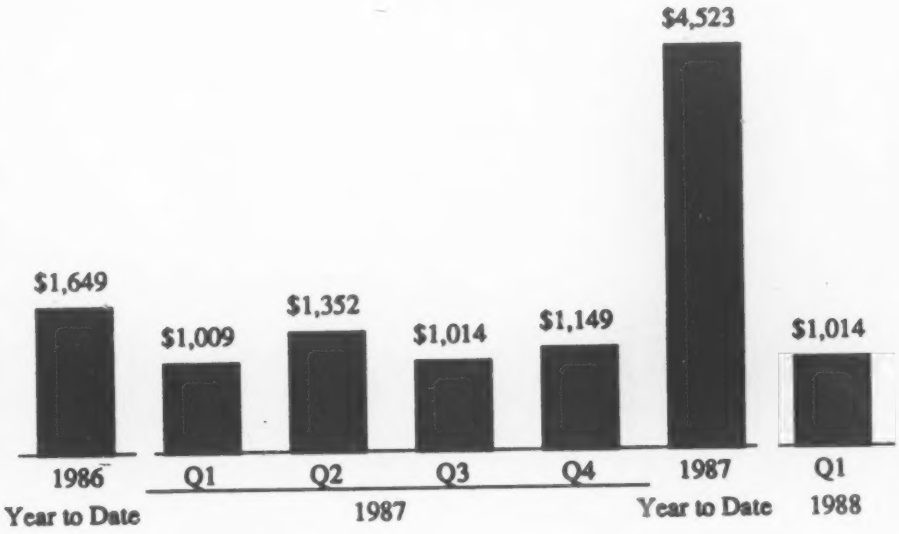


(See Exhibit I Chart 6 for detail)

EXHIBIT I - CHART 8

VOLUME OF LOANS RESTRUCTURED

($ MILLIONS)



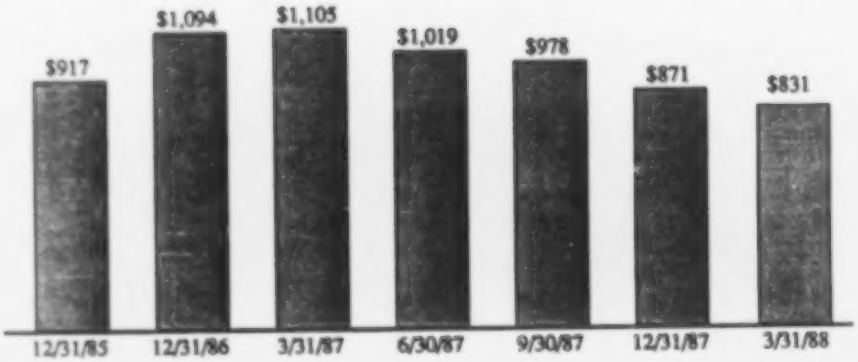
(See Exhibit I Chart 6 for detail)

INTENTIONAL
BLANK

EXHIBIT I - CHART 9

OTHER PROPERTY OWNED

($ MILLIONS)



FLB/FLBA and FICB/PCA balances only.

BC balances are immaterial.

EXHIBIT I - CHART 10

OPERATING EXPENSES
($ MILLIONS)

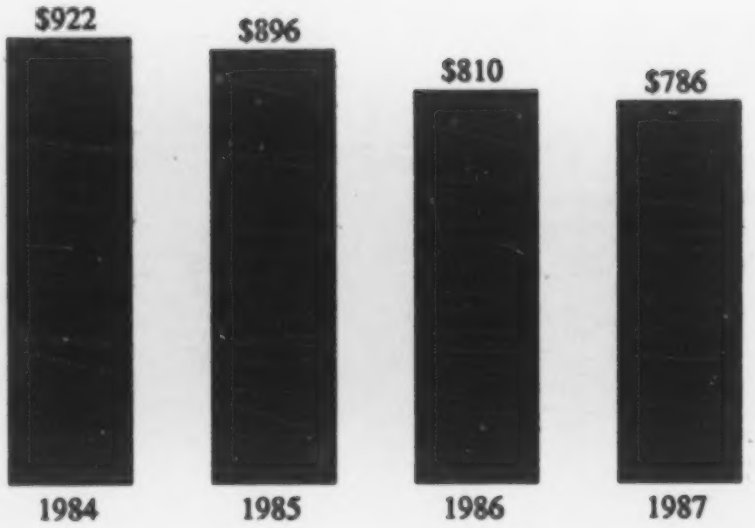


EXHIBIT II

FARM CREDIT SYSTEM BUSINESS PLAN

1988 - 1989

FARM CREDIT SYSTEM MISSION STATEMENT

THE FARM CREDIT SYSTEM WILL BE THE NATION'S PREMIER PROVIDER OF CREDIT AND FINANCIAL SERVICES TO FARMERS, RANCHERS, COOPERATIVES AND OTHER ELIGIBLE ENTITIES.

FARM CREDIT SYSTEM BUSINESS PLAN

TABLE OF CONTENTS

I. 1987 IN REVIEW

II. FARM CREDIT SYSTEM MISSION STATEMENT & STRATEGIC OBJECTIVES

III. ASSUMPTIONS

IV. FARM CREDIT SYSTEM BUSINESS PLAN

A. Business Plan Objectives

B. Business Plan Strategies

V. APPENDIX

Farm Credit System Key Indicators

FARM CREDIT SYSTEM BUSINESS PLAN

I. 1987 IN REVIEW

Like the industry it serves, the Farm Credit System is beginning to recover from perhaps the most difficult economic period since the Great Depression. With the passage of the Agricultural Credit Act of 1987, the System now has the critical tools it needs to regain its financial strength and restore borrower and investor confidence. These include:

1. Financial assistance to System borrowers, including protection of borrower stock;

2. Financial assistance to troubled System institutions;

3. Expanded borrower rights;

4. New capitalization requirements and authorities;

5. New requirements and authorities for streamlining System structure; and

6. A secondary mortgage market (SMM) for agricultural loans.

During 1987, while these new tools were being created, the System made significant progress on several of its business objectives and made more limited progress on others.

Most notable was the significant progress made in restructuring distressed loans and disposing of acquired property. In 1987, over 33,000 loans were restructured compared to 17,544 in 1986. The result of this more aggressive loan restructuring was a decline in nonaccrual loans of $1.8 billion or 26 percent as compared to year-end 1986. In addition, the System's acquired property declined in net amount by $225 million or 20 percent during the year.

Under the circumstances existing in 1987, the System fared relatively well in retaining quality customers and employees. The System's accruing loan volume dropped $3.8 billion or 7.4 percent to $47.3 billion at the end of 1987. This was better than projected. In many areas, pricing remained uncompetitive for much of the year. Not until late in 1987 did some districts begin offering a broader range of products to better serve customer needs.

Attempts to reduce operating costs and downsize in the face of loan volume declines resulted in reduced operating expenses but also in reduced morale and high turnover of valued employees. The innovative human resource programs called for in the Business Plan and required to retain and motivate employees in the face of uncertainty, stress and staff reductions are not in place in most districts; however, several districts are now taking steps to develop and test such programs.

Progress in streamlining the Farm Credit System and developing a more responsive credit delivery system was limited. One district undertook a major study of delivery system alternatives and is in the early stages of implementing the plan that resulted. Other districts made marginal changes to the traditional delivery methods by reducing loan documentation requirements on some loans, consolidating like associations, eliminating branch offices, etc. However, overall operating costs were only reduced by 3 percent or $24 million during 1987. It is important to note, however, that operating costs declined 12 percent during the last two years and operating cost reductions over this period of time were offset, in part, by the cost of servicing nonaccrual and other high-risk loans and disposing of acquired property.

The System made limited progress in improving the quality of its risk management programs. Several districts strengthened asset/liability management skills and practices; however, considerable additional progress is required. Credit quality during the year improved in all three bank groups. The percent acceptable FLB loans improved approximately 6 percent, FICB/PCA loans approximately 12 percent and BCs approximately 6 percent.

A litigation tracking system was developed in 1987 but has not yet been approved. Implementation is scheduled for 1988.

Financial strength declined in 1987 in some parts of the System, but overall that decline was not as much as expected. Net interest income declined from $781 million in 1986 to $509 million in 1987 or 35 percent. However, this decline was not as substantial as had been anticipated, in part because System institutions aggressively pursued loan restructuring and acquired property marketing efforts that resulted in returning non-earning loans to an earning status in many cases. Total capital declined $610 million or 11 percent during the year. On the other hand, during 1987 financial reporting accuracy was generally enhanced at a System level and at individual banks and associations. This resulted in greater confidence on the part of investors, stockholders and other interested parties in the financial statements of the System and its institutions.

The System's efforts to develop Systemwide financial projections for Congress resulted in greater awareness of the factors that influence financial performance. Additional efforts will be expended in 1988 to develop Systemwide financial planning models and forecasting processes.

Also provided in this plan in Appendix V is a detailed comparison of 1987 plans to actual results and 1988 plans as reflected by a series of key indicators. Please refer to that appendix for a more quantitative perspective of 1987 in review.

The 1987 Act and the changes in American agriculture resulting from its recent financial crisis will result in the most sweeping and dramatic changes in the Farm Credit System since the System was created more than 70 years ago. As System institutions have experienced firsthand in recent years, change brings both challenge and opportunity. More than ever before, these opportunities and challenges require well-planned, coordinated and decisive action.

This Farm Credit System Business Plan provides direction and focus for the System to plan, coordinate and act. While the System Mission Statement and Strategic Objectives provide long-term direction, the Business Objectives and Strategies are designed to focus System resources on the critical issues that must be addressed in 1988 and 1989.

Each Farm Credit bank, association and service entity is responsible for developing its own business plan consistent with this Farm Credit System Business Plan and local priorities. Through these coordinated business plans, the System can move in a single coordinated direction; yet each entity can respond effectively to the unique needs of its member borrowers.

II. FARM CREDIT SYSTEM MISSION STATEMENT AND OBJECTIVES

Farm Credit System Mission Statement

The Farm Credit System will be the nation's premier provider of credit and financial services to farmers, ranchers, cooperatives and other eligible entities.

Farm Credit System Strategic Objectives

The Farm Credit System will:

A. Be a dependable and responsive source of high-quality, financial and credit-related services to all qualified customers;

B. Price products on the basis of competition, risk incurred and cost of delivery;

C. Maximize efficiency and effectiveness in the delivery of products and services and in the management of human and physical resources;

D. Maximize long-term profitability to support growth, strengthen the Farm Credit System's capital base and provide a competitive return on owners' investment; and

E. Assess, manage and control credit, interest-rate and liquidity risks.

III. ASSUMPTIONS

1. Net cash income in agriculture is expected to decline in 1988 and 1989 from current record levels. Cash receipts from livestock are projected to remain at current to slightly higher levels in 1988 and then decline in 1989 while cash receipts from most crops are expected to increase. Production expenses are also projected to increase in 1988 and 1989. Overall land values have stabilized and are now beginning to show increases in most areas due to positive cash flows. Producers with high debt levels will face continued financial stress.

2. The total market for agricultural credit will continue to shrink. Competitive pricing practices and aggressive marketing may allow the Farm Credit System to prevent loan volume from dropping below $45 billion between 1988 and 1990; however, that level is down approximately 45 percent from the levels reached in the mid 1980s and should require commensurate adjustments in operating costs to remain competitive.

3. The Farm Credit System will continue to have access to the financial markets following enactment of the Agricultural Credit Act of 1987. The Farm Credit System's "all-in" cost of funds at the margin is expected to range from 10-80 basis points (average 55-65 basis points) over U.S. Treasury obligations of comparable maturities.

4. In the future, high performance competitors will obtain funds at approximately the same rate as the Farm Credit System when the cost of gathering deposits is included. Considering both short- and long-term farm loans and excluding deposit gathering costs, farm and ranch loan competitors will have an average operating cost of approximately 50-60 basis points for long-term loans and 150-200 basis points for operating loans.

5. Competition for creditworthy borrowers will increase significantly during the next two to three years. High performance competitors will continue to find more efficient ways to deliver credit to farmers and ranchers and will continue to generate fee income to enhance their overall profitability.

6. The future consumer of agricultural credit will have a greater variety of innovative credit and financial products available than ever before.

7. The general level of interest rates and the shape of the yield curve cannot be accurately predicted over time.

8. Long-term shifts in agriculture are expected to move toward more small part-time farms and more large farms with fewer middle-sized farms; however, current Federal farm programs are delaying that movement in some areas of the country.

9. There will be continuing demand for qualified and experienced loan officers. When coupled with continued job stress and mergers within the Farm Credit System, this will continue to cause problems in recruiting and retaining competent staff.

10. The Federal Land Bank and the Federal Intermediate Credit Bank in each district will be merged by July 6, 1988.

11. A national vote on consolidation of the Banks for Cooperatives will occur in June 1988, and some BCs will elect to merge. Such mergers may have a substantial effect on FCB operating cost.

12. Stockholder votes on the merger of FLBAs with PCAs and mergers of like associations will occur in late 1988 with a wide range of association configurations and structures resulting. Merged associations will have direct lending authority for both short- and long-term loans. Some FLBAs will have direct lending authority for long-term loans. Relationships between banks and associations will change significantly in some districts, resulting in different relationships in different districts. There will be increasing competition between and among Farm Credit institutions. Some associations will consider leaving the System and/or changing districts according to provisions of the Agricultural Credit Act of 1987.

13. Proposals for merging districts will be considered during 1988 and 1989 with the likelihood that less than 12 districts will result.

14. A secondary mortgage market for agricultural loans will be established in late 1988 or early 1989 and will create increased competition for the Federal Land Banks' high quality customers.

15. Parts of the Farm Credit System will receive financial assistance and the related government oversight. The Farm Credit System as a whole will have an increased obligation to keep Congress informed on the progress of implementing the 1987 Act.

16. Cooperative mergers and restructuring will have a major impact on the financial requirements of cooperatives and the financial services requested by them.

17. During the next five years, new entrants in the ag finance business will compete for farm and ranch loans.

18. Banks and associations will be required to raise permanent capital according to new capital adequacy regulations and borrowers will not be willing to capitalize their Farm Credit institutions with at-risk capital without the prospect of a market return on that investment.

IV. FARM CREDIT SYSTEM BUSINESS PLAN

A. BUSINESS PLAN OBJECTIVES

To return the Farm Credit System to profitability and accomplish the Farm Credit System's Strategic Objectives, the Farm Credit System establishes the following Business Plan Objectives for 1988 and 1989:

1. Work with troubled accounts to reduce non-earning assets, restructure loans when appropriate and manage acquired property effectively;

2. Attract and retain quality customers and employees;

3. Transform the System into a streamlined, efficient and competitive provider of credit and financial services;

4. Implement programs to assess, manage and control interest-rate, credit, liquidity and other risks; and

5. Regain System financial strength and reputation, and maintain System independence.

B. BUSINESS PLAN STRATEGIES

Included for each major Business Plan Objective are "Bank and Association Strategies" which should receive bank and/or association action or planning. Also included is a section labeled "Systemwide Strategies " These strategies reflect direction from the Presidents Planning Committee and FCCA board of directors to the Farm Credit System service entities which request action and/or planning by one or more of the service organizations. This Business Plan update was developed based on a consensus of association, bank and service entity input. Refinements this year include the elimination of imperatives, recognizing people in positions of influence are responsible business managers and will recognize the importance of these issues in light of regional and local priorities.

Many of the strategies are similar to those contained in the May 1987 Farm Credit System Business Plan. It is recognized that many institutions will have already adopted and commenced implementation of the designated policies, standards and guidelines. The policies, guidelines and standards referenced herein are contained in the Farm Credit System Standards and

Guidelines Manual which is prepared and periodically updated by the Farm Credit Corporation of America.

Quantitative key indicators are included in the Business Plan. The consolidated Systemwide key indicator targets contained herein are a consolidation of bank and association data which was reviewed, adjusted where appropriate, and approved by the Presidents Planning Committee. Individual banks and associations may have key indicator targets that are more aggressive than those in this Business Plan.

Business Plan Objective 1. Continue to work with troubled accounts to reduce non-earning assets, restructure loans when appropriate and manage acquired property effectively.

Bank and Association Strategies

a. It is recommended that each bank and association adopt and implement the Model Distressed Loan Restructuring Policy and the revised Farm Credit System Guidelines and Definitions for Restructuring System Loans, and report results and communicate, as appropriate, to its respective publics.

b. It is recommended that each bank and association set nonaccrual key indicator targets. The Farm Credit System has the following consolidated nonaccrual loan targets for year-end 1988:

($ Millions)

	FLB/ FLBA	FICB/ PCA	BC	Farm Credit System*
• Nonaccrual Loan Volume				
Beginning of Year	4,366.8	856.4	10.8	5,234.1
End of Year	3,158.1	625.0	63.4	3,846.5
• Amount of Loans Restructured	263.7	116.2	-	379.9
• Loans to Acquired Property	942.5	128.3	8.6	1,079.4
• Amount of Loans Charged Off	387.2	12.1	0	399.3

*The Farm Credit System totals in this document may not equal the sum of the individual bank group data due to combining entries and rounding.

c. It is recommended that each bank and association adopt and implement the revised Farm Credit System Guidelines and Definitions for Management and Disposition of Acquired Property, report results and communicate, as appropriate, to its respective publics.

Business Plan
Objective 1. (continued)

d. It is recommended that each bank and association set acquired property key indicator targets. The Farm Credit System has the following consolidated acquired property targets for year-end 1988:

($ Millions)

	FLB/ FLBA	FICB/ PCA	BC	Farm Credit System
• Amount of Acquired Property				
Beginning of Year	829.7	156.5	8.2	994.4
End of Year	716.3	126.7	8.1	851.1
• Acquired Property Sales	874.6	107.6	-	982.2
• (Loss)/Gain on Disposal of Acquired Property	103.9	8.3	1.0	113.2

e. It is recommended that each bank and association aggressively implement borrower rights provisions of the 1987 Act.

f. During the annual budgeting process, each bank and association should review each non-earning asset (other than loans or acquired property), perform a cost/benefit analysis of retaining those assets and reflect decisions in annual budgets.

g. It is recommended that each bank and association set targets for non-earning assets as a percent of previous year-end loan volume. The Farm Credit System has the following Systemwide non-earning asset targets for 1988:

Business Plan
Objective 1. (continued)

	FLB/ FLBA	FICB/ PCA	BC	Farm Credit System
• Non-Earning Assets (Other than Loans and Acquired Property) as a Percent of Previous Year-End Loan Volume	6.1%	10.3%	3.7%	6.5%

Systemwide Strategies

a. The Farm Credit Corporation of America will compile Farm Credit System data, coordinate System efforts to implement borrower rights provisions of the 1987 Act, monitor compliance with loan restructuring and acquired property guidelines and work with bank management and directors to achieve desired levels of performance.

b. The Farm Credit Corporation of America and The Farm Credit Council will communicate Farm Credit System loan restructuring and acquired property results and progress in implementing borrower's rights provisions to appropriate publics.

Business Plan Objective 2. Attract and retain quality customers and employees.

Bank and Association Strategies

a. It is recommended that each bank and association develop and implement a broad range of profitable programs and services to better serve customer needs and to increase interest and non-interest revenue.

b. It is recommended that each bank and association price products consistent with the Farm Credit System Model Pricing Program (February 1987 version) and fully implement the Farm Credit System Model Competitor Analysis Program or a comparable competitor analysis program.

c. It is recommended that each bank and association use the 1988 Marketing Evaluation Guide to review and evaluate existing marketing and communications programs and develop and implement programs to improve market share and image.

d. It is recommended that each bank and association review and adopt marketing strategies contained in the Farm Credit System 1987 Agricultural Credit Market Study.

e. It is recommended that each bank and association set loan volume key indicator targets. The Farm Credit System has the following consolidated loan volume targets for year-end 1988:

($ Millions)

	FLB/ FLBA	FICB/ PCA	BC	Farm Credit System
• % Market Share				
• Accruing Loan Volume	28,980.6	9,189.3	7,699.9	45,869.8
• Loans to Nonaccrual Status	1,128.3	796.8	35.0	1,960.1
• New Accruing Loan Volume	1,724.0	685.4	238.6	2,648.0
• Credit Quality as Reflected by Percent of Loans "Acceptable Loans and OAEM"	*	*	*	*

*To be developed.

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Business Plan
Objective 2. (continued)

f. It is recommended that each bank and association maintain a continuing, constructive and proactive relationship with appropriate legislative and governmental individuals and groups.

g. It is recommended that each bank and association review and evaluate existing human resource programs and marketing/sales skills and consider Farm Credit System model human resource programs to help identify, attract, train or retain key employees.

h. It is recommended that each bank and association provide quality training programs to its employees to improve technical proficiencies and marketing/sales skills.

i. It is recommended that each bank consider and evaluate the potential for being certified as a Secondary Mortgage Market Certified Facility and evaluate the merits of purchasing non-System loans.

j. It is recommended that each association consider and evaluate the potential for originating loans that would qualify for sale into the Secondary Mortgage Market.

Systemwide Strategies

a. The Farm Credit Corporation of America will coordinate the exploration, testing and development of new profit-generating Farm Credit System products and services to better serve American agriculture.

b. Farm Credit System entities, with coordination provided by FCCA, will consider purchase of FmHA or other government assets where risk and profit potential warrant and/or service such assets for a fee.

c. The Farm Credit Corporation of America will update and expand the national data base of market information to guide development of new products and services.

Business Plan
Objective 2. (continued)

d. The Farm Credit Corporation of America, in coordination with The Farm Credit Council, the Federal Farm Credit Banks Funding Corporation and the Farm Credit System banks, will manage a public affairs agenda which enhances the public perception of the System, supports bank and association efforts to rebuild borrower confidence, and forms new allies with business, academic, public and agricultural groups.

e. The Farm Credit Corporation of America, in coordination with The Farm Credit Council, the Federal Farm Credit Banks Funding Corporation and Farm Credit System banks, will continue an ongoing schedule of meetings with leaders of national financial, media and legislative organizations to maintain and/or improve working relationships.

f. The Farm Credit System, through The Farm Credit Council and in coordination with the Farm Credit Corporation of America, will assure a continuing, effective relationship with appropriate legislative and governmental bodies and will maintain necessary alliances and contingency plans to adequately respond to legislative threats or opportunities.

g. The Farm Credit Corporation of America will develop and implement the following human resource initiatives:

(1) Model Systemwide benefits programs;

(2) Pilot testing of model "pay-for-performance" and incentive compensation programs;

(3) A model executive compensation program;

(4) A model affirmative action plan document; and

(5) Pilot testing of model human resource planning and selection programs focused on association personnel.

h. The Farm Credit Corporation of America will coordinate and monitor appraisal training programs and work with System entities to improve appraiser proficiency and effectiveness.

i. The Farm Credit System Secondary Mortgage Market Advisory Committee will provide leadership and direction for a coordinated System direction and response to the Secondary Mortgage Market for agricultural loans established in the 1987 Act.

Business Plan
Objective 2. (continued)

j. The Farm Credit System Secondary Mortgage Market Advisory Committee will develop a proposal for establishing a Farm Credit System Certified Facility for the purpose of securitizing and marketing loan pools on behalf of System and other certified facilities.

k. The Farm Credit Corporation of America will coordinate efforts and develop model programs to assist banks in becoming certified as Farmer Mac Certified Facilities and to assist associations in becoming Farmer Mac originators.

Business Plan Objective 3. Transform the Farm Credit System into a streamlined, efficient and competitive provider of credit and financial services.

Bank and Association Strategies

a. It is recommended that each bank and association evaluate its functions and operations to determine how the new restructuring authorities in the Agricultural Credit Act of 1987 can be used to improve profitability and competitiveness, streamline delivery systems, reduce operating costs and better serve customers.

b. It is recommended that each bank and association set operating cost key indicator targets. The Farm Credit System has the following consolidated operating cost targets for 1988:

($ Millions)

	FLB/ FLBA	FICB/ PCA	BC	Farm Credit System
• Bank Operating Cost	126.8	86.3	48.4	261.5
• Association Operating Cost	206.9	212.4	0	419.3
• Allocated System Cost	10.3	5.1	3.0	18.4
• Regulator's Cost	15.9	13.6	4.9	34.4

c. It is recommended that each bank and association maintain an arm's-length relationship with the Farm Credit Administration that supports the movement of the regulator away from management and contributes to the extent possible to reductions in regulatory cost and time delays.

d. It is recommended that each bank implement Farm Credit System business technology standards and report results to the Farm Credit Corporation of America.

e. It is recommended that each bank, in coordination with the Credit and Operations Committee, evaluate expanded MIS and technology applications that will improve flexibility to meet market needs, serve associations more cost effectively and/or streamline operations.

f. It is recommended that each bank and association implement the computerized Credit Analysis Package (C.A.P.).

Systemwide Strategies

a. The Farm Credit System "Special Committee" on district consolidations will develop a proposal to consolidate the Farm Credit System banks into no less than six financially viable Farm Credit Banks which will allow the System to improve profitability and competitiveness, streamline its delivery system, reduce operating costs and better serve its customers.

b. The PPCEC will analyze the long-term cost structure needed by the Farm Credit System to remain competitive and viable.

c. The Farm Credit System service organizations and the Presidents Planning Committee, respectively, will evaluate and adjust, as needed, how the functions and responsibilities of each service organization and System committee can best and most cost-effectively be provided to maximize the overall benefit to the Farm Credit System.

d. Farm Credit System service entities will maintain an arm's-length relationship with the Farm Credit Administration that supports the movement of the regulator away from management and contributes to the extent possible to reductions in regulatory cost and time delays.

e. The Farm Credit Corporation of America will continue to assist the Farm Credit System in reducing operating costs by providing support services in risk and insurance management, planning, human resource management, marketing and communications, financial management and reporting, information management, credit and asset management and joint purchase of services and materials used by Farm Credit System institutions.

f. The Farm Credit Corporation of America will monitor compliance with business technology standards, work with bank management and directors to achieve desired progress and assist banks in evaluating expanded MIS/technology applications and in implementing the Credit Analysis package.

Business Plan Objective 4.	Implement programs to assess, manage and control interest-rate, credit, liquidity and other risks.

Bank and Association Strategies

a. It is recommended that each bank and association adopt and implement the revised Farm Credit System National Credit and Review Standards.

b. It is recommended that each bank and association adopt and implement the Farm Credit System Appraisal Guidelines and Definitions.

c. It is recommended that each bank adopt an asset liability policy statement consistent with the Farm Credit System Asset/Liability Policy Statement and implement necessary asset/liability tools and practices, including an asset/liability committee that represents appropriate constituencies and is empowered to make required decisions.

d. It is recommended that banks set asset/liability key indicator targets, consistent with bank and association goals to manage interest-rate risk and maximize net interest income.

e. It is recommended that each bank comply with Farm Credit Banks Minimum Liquidity Guidelines.

f. It is recommended that banks adopt and implement Phase I of the Uniform Standards for Reporting of Litigation to the Farm Credit Banks which will provide standardized information from associations to district banks and better enable the Farm Credit Corporation of America to monitor litigation risk on a Systemwide basis and furnish necessary disclosure information to the Funding Corporation and its disclosure counsel.

Systemwide Strategies

a. The Farm Credit Corporation of America will revise the Farm Credit System National Credit and Review Standards.

b. The Funding Corporation and the Farm Credit Corporation of America will revise the Farm Credit System Asset/Liability Policy Statement.

Business Plan
Objective 4. (continued)

c. The Presidents Planning Committee will adjust as needed the Farm Credit Banks Mininum Liquidity Guidelines.

d. The Farm Credit Corporation of America and/or the Federal Farm Credit Banks Funding Corporation will compile Farm Credit System data and monitor compliance with the above Farm Credit System standards and guidelines and work with bank management and directors to achieve desired levels of performance.

e. The Farm Credit Corporation of America will engage and manage the various legal counsel and consultants retained for Systemwide issues and, after receiving the recommendations of the Farm Credit System Audit Committee, the Systemwide independent accountants.

f. The Farm Credit Corporation of America will complete development of and implement phase I of the Uniform Standards for Reporting of Litigation to the Farm Credit Banks which will provide standardized information from associations to district banks and better enable the Farm Credit Corporation of America to monitor litigation risk on a Systemwide basis and furnish necessary disclosure information to the Funding Corporation and its disclosure counsel.

Business Plan Objective 5. Regain Farm Credit System financial strength and reputation, and maintain System independence.

Bank and Association Strategies

a. It is recommended that each bank and association develop and adopt a new capitalization plan consistent with final capital adequacy regulations and the resulting Farm Credit System Financial Standards and Guidelines.

b. It is recommended that each bank and association integrate updated key indicator targets into its Business Plan on an ongoing basis. This Business Plan, together with the quantifiable targets, is intended to be the "Financial Plan" required by the Farm Credit Administration.

c. It is recommended that each bank and association set financial key indicator targets. The Farm Credit System has the following consolidated financial key indicator targets or expectations for 1988:

($ Millions)

	FLB/ FLBA	FICB/ PCA	BC	Farm Credit System
• Average Interest Rate Charged	10.50%	9.97%	8.72%	10.33%
• Average Cost of Funds	9.96%	8.63%	7.76%	9.31%
• Net Interest Income	(26.6)	284.0	126.0	383.4
• Allowance for Loan Losses	1,593.8	475.2	138.2	2,207.2
• Annual Provision for Loan Losses	(265.9)	(137.3)	(1.8)	(405.0)
• Allowance for Losses - Acquired Property	86.4	9.9	2.0	98.3
• Annual Provision - Acquired Property	10.4	0	0	10.4
• Net Income/(Loss) (GAAP)	89.2	59.3	77.9	226.4

Business Plan
Objective 5. (continued)

	($ Millions)			
	FLB/ FLBA	FICB/ PCA	BC	Farm Credit System
• Excess/Deficit Collateral	340.6	1,234.5	1,101.0	2,676.1
• Loanable Funds	(741.1)	1,780.4	1,612.4	2,651.7

d. It is recommended that each bank and association utilize the key indicator targets to monitor and report progress in achieving Business Plan Strategies and compliance with the five-year phase in of capital adequacy regulations.

e. It is recommended that each bank and association develop its own Business Plan consistent with local priorities and this Farm Credit System Business Plan.

Systemwide Strategies

a. The Farm Credit Corporation of America will develop model capitalization programs consistent with capital adequacy regulations and Farm Credit System Financial Standards and Guidelines as required to regain and maintain financial viability.

b. The Farm Credit Corporation of America will develop a Systemwide financial planning model to provide the capability of consistent financial forecasts and analyses.

c. The Farm Credit Corporation of America will coordinate development of a strategy for repayment of federal financial assistance.

d. The Farm Credit Corporation of America will implement and maintain a Systemwide reporting structure to serve the reporting and monitoring needs of the banks, associations, Farm Credit Administration, Farm Credit Corporation of America, Farm Credit System committees and other Farm Credit System entities.

Business Plan
Objective 5. (continued)

e. Accurate and timely consolidated financial information will be prepared and audited through the Farm Credit Corporation of America and the Farm Credit System Audit Committee and will be reported and disclosed through the Federal Farm Credit Banks Funding Corporation as appropriate.

f. Each service entity will develop its own Business Plan consistent with this Farm Credit System Business Plan. In developing such plans, each service entity will communicate and coordinate with other service entity plans to avoid duplication and improve overall cost effectiveness.

g. The Farm Credit Corporation of America will monitor progress on the Business Plan and make periodic progress reports to the Farm Credit System.

V. APPENDIX - Farm Credit System Key Indicators

Comparison of 1987 Plan to
1987 Actual and 1988 Plan

FARM CREDIT SYSTEM
COMBINED
KEY INDICATORS
($ Millions)

		1987 Target	1987 Actual	1988 Plan
	Accruing Loans			
1)	Accruing Loan Volume	$44,543.4	$47,264.0	$45,869.8
2)	Loans to Non-Accrual Status	4,747.5	3,148.1	1,960.1
3)	New Accruing Loan Volume	2,443.3	3,789.3	2,648.0
4)	Amount of Borrower Prepayment	3,252.5	4,024.8	N/A
5)	Amount of Normal Borrower Repayment (FLB Only)	990.5	5,468.3	N/A
	Non-Accrual Loans			
6)	Non-Accrual Loan Volume	6,223.1	5,234.1	3,846.5
7)	Amount of Loans Restructured	995.7	1,091.2	379.9
8)	Loans Liquidated for Cash	965.5	1,785.3	726.4
9)	Loans to Acquired Property	2,029.4	1,134.9	1,079.4
10)	Amount of Loans Charged Off	1,593.8	488.4	399.3
	Acquired Property			
11)	Amount of Acquired Property	1,809.3	994.3	851.1
12)	Acquired Property Sold for Cash	607.0	753.3	538.8
13)	Amount of Acquired Property to Sales Contracts	864.2	619.8	443.4
14)	(Loss)/Gain on Disposal of Acquired Property	229.6	245.2	113.2
	Loan Pricing			
15)	Average Interest Rate Charged	10.24%	10.30%	10.33%
16)	Average Cost of Funds	8.76%	9.25%	9.31%
17)	Net Interest Income	320.4	508.9	383.4
	Operating Cost Structure			
18)	Bank Operating Cost	269.1	282.4	261.5
19)	Association Operating Cost	479.6	452.4	419.3
20)	Allocated System Cost	21.0	14.7	18.4
21)	Regulators Cost	34.9	36.6	34.4
	Allowance for Loan Losses			
22)	Allowance for Loan Losses	2,801.8	2,951.0	2,207.2
23)	Annual Provision	760.3	(195.9)	(405.0)
24)	Allowance for Losses on Acquired Property	309.7	117.7	98.3
25)	Annual Provision	145.8	106.1	10.4
	Net Income and Other			
26)	Net Income (GAAP)	(1,281.5)	(17.5)	226.4
27)	Loanable Funds	(2,650.4)	1,511.3	2,651.7

FARM CREDIT SYSTEM
FEDERAL LAND BANK GROUP
KEY INDICATORS
($ Millions)

		1987 Target	1987 Actual	1988 Plan
	Accruing Loans			
1)	Accruing Loan Volume	$28,339.5	$29,979.3	$28,980.6
2)	Loans to Non-Accrual Status	3,874.8	2,693.0	1,128.3
3)	New Accruing Loan Volume	1,367.6	1,333.3	1,724.0
4)	Amount of Borrower Prepayment	3,252.5	3,562.1	-
5)	Amount of Normal Borrower Repayment	990.5	752.8	-
	Non-Accrual Loans			
6)	Non-Accrual Loan Volume	5,124.9	4,366.8	3,158.1
7)	Amount of Loans Restructured	878.8	845.3	263.1
8)	Loans Liquidated for Cash	680.1	1,346.3	552.1
9)	Loans to Acquired Property	1,815.5	1,021.9	942.5
10)	Amount of Loans Charged Off	1,228.8	402.0	387.2
	Acquired Property			
11)	Amount of Acquired Property	1,547.9	829.7	716.3
12)	Acquired Property Sold for Cash	501.6	641.3	455.6
13)	Amount of Acquired Property to Sales Contracts	790.7	548.0	419.0
14)	(Loss)/Gain on Disposal of Acquired Property	191.4	217.9	103.9
	Loan Pricing			
15)	Average Interest Rate Charged	10.92%	10.86%	10.50%
16)	Average Cost of Funds	9.59%	10.16%	9.96%
17)	Net Interest Income	(117.3)	17.1	(26.6)
	Operating Cost Structure			
18)	Bank Operating Cost	127.6	135.8	126.8
19)	Association Operating Cost	222.3	214.5	206.9
20)	Allocated System Cost	13.0	7.7	10.3
21)	Regulators Cost	15.9	16.1	15.9
	Allowance for Loan Losses			
22)	Allowance for Loan Losses	2,010.6	2,186.4	1,593.8
23)	Annual Provision	530.8	(89.0)	(265.9)
24)	Allowance for Losses on Acquired Property	254.3	90.8	86.4
25)	Annual Provision	125.7	86.9	10.4
	Net Income and Other			
26)	Net Income (GAAP)	(1,074.0)	(186.4)	89.2
27)	Loanable Funds	(4,689.7)	(1,766.9)	(741.1)

FARM CREDIT SYSTEM
FEDERAL INTERMEDIATE CREDIT BANK GROUP
KEY INDICATORS
($ Millions)

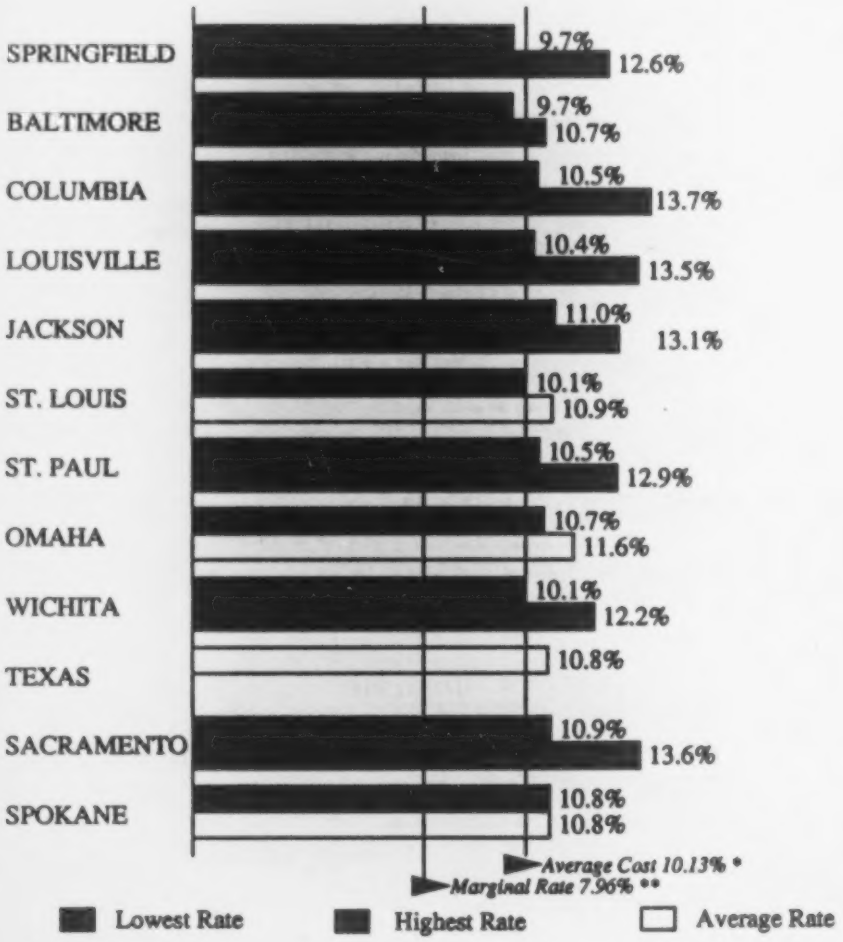
		1987		1988
	Accruing Loans	Target	Actual	Plan
1)	Accruing Loan Volume	$8,540.6	$9,070.5	$9,189.3
2)	Loans to Non-Accrual Status	833.5	457.6	796.8
3)	New Accruing Loan Volume	602.1	1,931.0	685.4
4)	Amount of Borrower Prepayment	- 1,767.1	462.7	-
5)	Amount of Normal Borrower Repayment	-	4,715.5	-
	Non-Accrual Loans			
6)	Non-Accrual Loan Volume	1,043.2	856.4	625.0
7)	Amount of Loans Restructured	112.6	144.6	116.2
8)	Loans Liquidated for Cash	270.9	429.0	174.3
9)	Loans to Acquired Property	201.1	113.0	128.3
10)	Amount of Loans Charged Off	365.7	46.7	12.1
	Acquired Property			
11)	Amount of Acquired Property	248.1	156.5	126.7
12)	Acquired Property Sold for Cash	98.0	112.0	83.2
13)	Amount of Acquired Property to Sales Contracts	72.4	71.8	24.4
14)	(Loss)/Gain on Disposal of Acquired Property	37.7	26.3	8.3
	Loan Pricing			
15)	Average Interest Rate Charged	9.60%	9.80%	9.97%
16)	Average Cost of Funds	6.95%	7.83%	8.63%
17)	Net Interest Income	315.3	353.7	284.0
	Operating Cost Structure			
18)	Bank Operating Cost	90.8	89.3	86.3
19)	Association Operating Cost	257.3	237.9	212.4
20)	Allocated System Cost	5.0	4.0	5.1
21)	Regulators Cost	14.3	16.2	13.6
	Allowance for Loan Losses			
22)	Allowance for Loan Losses	640.5	623.6	475.2
23)	Annual Provision	225.2	(100.2)	(137.3)
24)	Allowance for Losses on Acquired Property	53.6	24.5	9.9
25)	Annual Provision	20.1	17.8	0
	Net Income and Other			
26)	Net Income (GAAP)	(259.6)	119.8	59.3
27)	Loanable Funds	938.6	1,710.1	1,780.4

FARM CREDIT SYSTEM
BANK FOR COOPERATIVES GROUP
KEY INDICATORS
($ Millions)

		1987 Target	1987 Actual	1988 Plan
	Accruing Loans			
1)	Accruing Loan Volume	$7,663.3	$8,213.9	$7,699.9
2)	Loans to Non-Accrual Status	39.2	N/A	35.0
3)	New Accruing Loan Volume	473.6	525.0	238.6
	Non-Accrual Loans			
6)	Non-Accrual Loan Volume	55.0	10.8	63.4
7)	Amount of Loans Restructured	4.3	101.3	-
8)	Loans Liquidated for Cash	14.5	10.0	-
9)	Loans to Acquired Property	12.8	N/A	8.6
10)	Amount of Loans Charged Off	(0.7)	(2.0)	0
	Acquired Property			
11)	Amount of Acquired Property	13.3	8.2	8.1
12)	Acquired Property Sold for Cash	7.4	N/A	N/A
13)	Amount of Acquired Property to Sales Contracts	1.1	N/A	N/A
14)	(Loss)/Gain on Disposal of Acquired Property	0.5	1.0	1.0
	Loan Pricing			
15)	Average Interest Rate Charged	8.30%	8.36%	8.72%
16)	Average Cost of Funds	7.52%	7.53%	7.76%
17)	Net Interest Income	122.3	128.8	126.0
	Operating Cost Structure			
18)	Bank Operating Cost	50.7	50.1	48.4
19)	Association Operating Cost	-	-	-
20)	Allocated System Cost	3.0	3.0	3.0
21)	Regulators Cost	4.7	4.3	4.9
	Allowance for Loan Losses			
22)	Allowance for Loan Losses	150.7	141.0	138.2
23)	Annual Provision	4.3	(6.8)	(1.8)
24)	Allowance for Losses on Acquired Property	1.8	2.4	2.0
25)	Annual Provision	0.0	1.4	0
	Net Income and Other			
26)	Net Income (GAAP)	52.0	78.5	77.9
27)	Loanable Funds	1,100.7	1,568.1	1,612.4

EXHIBIT III - CHART 1

FARM CREDIT SYSTEM RATE COMPARISIONS SELECTED LONG TERM LOAN PRODUCTS 4TH QUARTER 1987

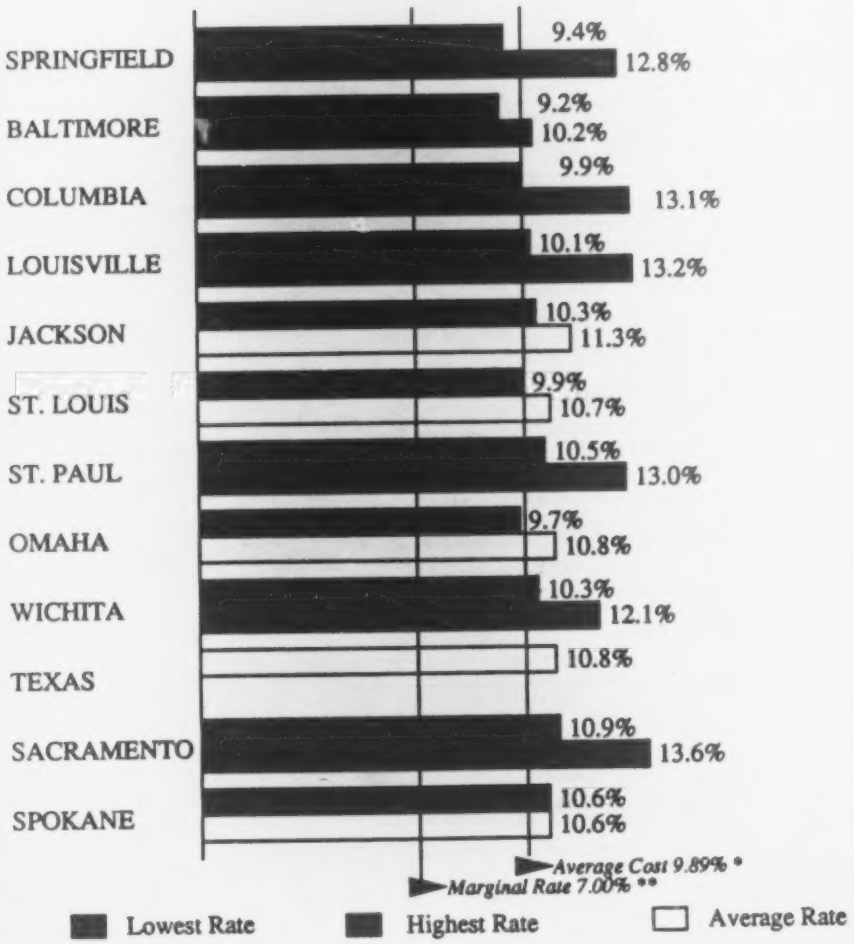


** Average Cost Of Funds, Federal Land Bank Group*

*** New Issue Rate, Farm Credit One Year Bonds*

EXHIBIT III - CHART 2

FARM CREDIT SYSTEM RATE COMPARISIONS SELECTED LONG TERM LOAN PRODUCTS 1ST QUARTER 1988

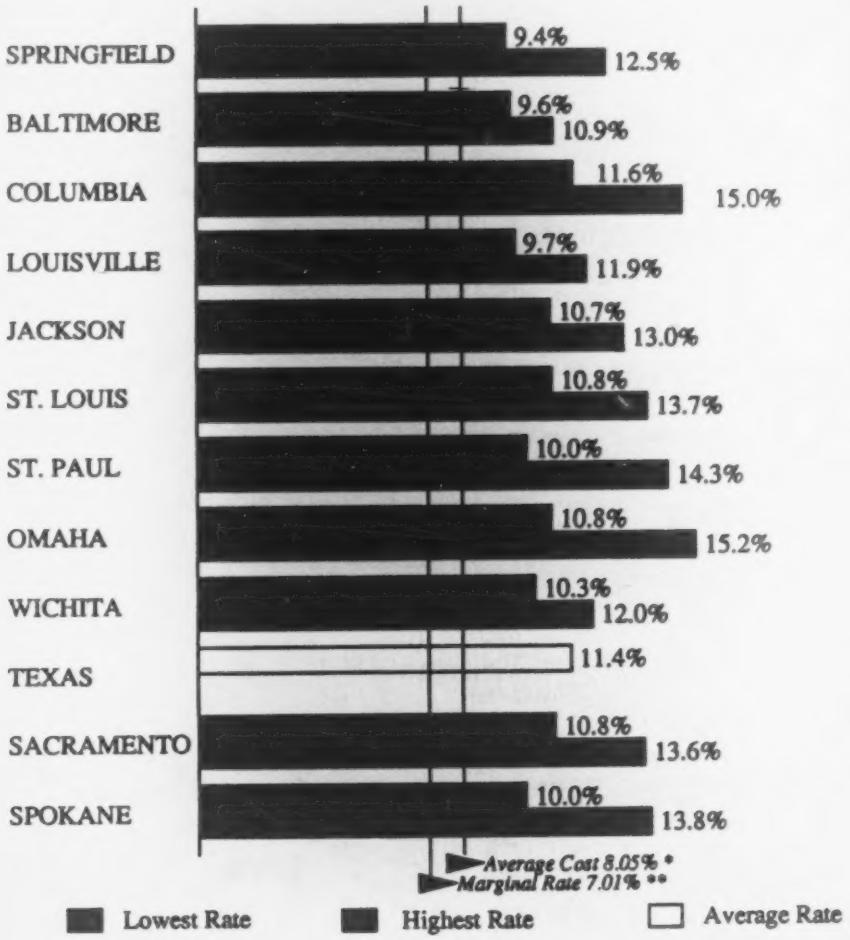


** Average Cost Of Funds, Federal Land Bank Group*

*** New Issue Rate, Farm Credit One Year Bonds*

EXHIBIT III - CHART 3

FARM CREDIT SYSTEM RATE COMPARISIONS SELECTED SHORT TERM LOAN PRODUCTS 4TH QUARTER 1987

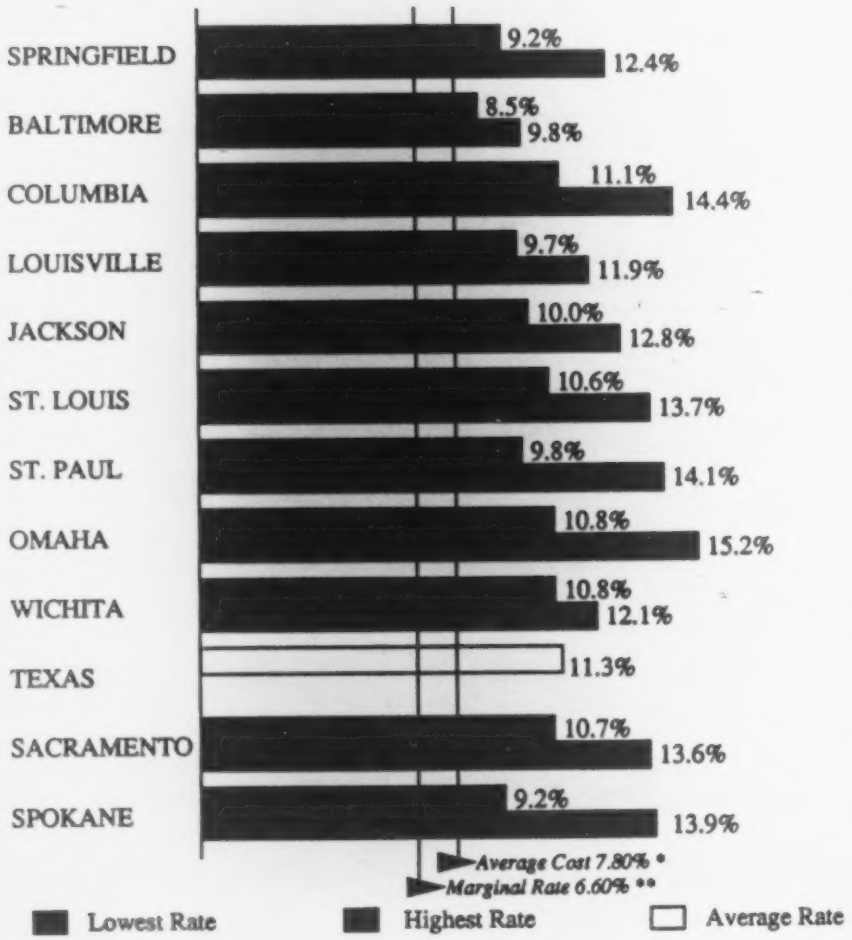


** Average Cost Of Funds, Federal Intermediate Credit Bank Group*

*** New Issue Rate, Farm Credit Three Month Bonds*

EXHIBIT III - CHART 4

FARM CREDIT SYSTEM RATE COMPARISIONS SELECTED SHORT TERM LOAN PRODUCTS 1ST QUARTER 1988



* *Average Cost Of Funds, Federal Intermediate Credit Bank Group*

** *New Issue Rate, Farm Credit Three Month Bonds*

SPRINGFIELD RATE COMPARISONS
12/31/87 AND 3/31/88

	FCS RATES 12/31/87			FCS RATES 3/31/88		
LOAN TYPE	LOW	AVG.	HIGH	LOW	AVG.	HIGH
Operating Repriced 1 mo. or < 2 to 6 7 or >	9.43	10.10	12.46	9.22	9.82	12.38
Int. Term Repriced 1 mo. or < 2 to 36 37 or >	9.43	10.10	12.46	9.22	9.82	12.38
Long Term Repriced 1 mo. or < 2 to 36 37 or >	9.74	10.79	12.64	9.36	10.16	12.78

In some cases, the rates shown are the average rate for several loan products within each loan type and associations within a district. As a result, some associations may have lower published rates for individual loan products than those listed above.

Definitions

Operating - < = 12 months
Int. Term - 13 months to 10 years
Long Term - > 10 years
Rates are adjusted for stock

BALTIMORE RATE COMPARISONS
12/31/87 AND 3/31/88

LOAN TYPE	FCS RATES 12/31/87 LOW	AVG.	HIGH	FCS RATES 3/31/88 LOW	AVG.	HIGH
Operating Repriced						
1 mo. or <	9.55	10.20	10.85	8.50	9.15	9.80
2 to 6	9.60	10.25	10.90	8.65	9.30	9.95
7 or >	9.70	10.35	11.00	8.85	9.50	10.15
Int. Term Repriced						
1 mo. or <	9.50	10.15	10.80	9.10	9.75	10.40
2 to 36	10.00	10.65	11.30	9.30	9.95	10.60
37 or >	10.45	11.10	11.75	9.80	10.45	11.10
Long Term Repriced						
1 mo. or <						
2 to 36	9.70	10.20	10.70	9.20	9.70	10.20
37 or >	11.35	11.85	12.35	10.85	11.35	11.85

In some cases, the rates shown are the average rate for several loan products within each loan type and associations within a district. As a result, some associations may have lower published rates for individual loan products than those listed above.

Definitions

Operating - < = 12 months
Int. Term - 13 months to 10 years
Long Term - > 10 years
Rates are adjusted for stock

COLUMBIA RATE COMPARISONS
12/31/87 AND 3/31/88

	FCS RATES 12/31/87			FCS RATES 3/31/88		
LOAN TYPE	LOW	AVG.	HIGH	LOW	AVG.	HIGH
Operating Repriced						
1 mo. or <	11.61	13.28	14.96	11.06	12.75	14.43
2 to 6						
7 or >	11.55	13.23	14.91	10.62	12.30	13.98
Int. Term Repriced						
1 mo. or <	10.97	12.64	14.32	10.42	12.09	13.77
2 to 36	11.14	12.81	14.96	10.58	12.26	13.94
37 or >	11.59	13.26	14.94	11.14	12.82	14.58
Long Term Repriced						
1 mo. or <						
2 to 36	10.45	12.05	13.65	9.91	11.51	13.11
37 or >	10.71	12.31	13.91	10.71	12.31	13.91

In some cases, the rates shown are the average rate for several loan products within each loan type and associations within a district. As a result, some associations may have lower published rates for individual loan products than those listed above.

Definitions

Operating - < = 12 months
Int. Term - 13 months to 10 years
Long Term - > 10 years
Rates are adjusted for stock

Previously, the interest rates reported for Columbia were adjusted for stock only. This comparison has been revised to reflect effective interest rates, taking into consideration stock requirements and/or points and fees.

LOUISVILLE RATE COMPARISONS
12/31/87 AND 3/31/88

	FCS RATES 12/31/87			FCS RATES 3/31/88		
LOAN TYPE	LOW	AVG.	HIGH	LOW	AVG.	HIGH
Operating Repriced						
1 mo. or <	9.67	10.76	11.85	9.67	10.76	11.85
2 to 6				9.67	10.76	11.85
7 or >				9.67	10.76	11.85
Int. Term Repriced						
1 mo. or <				9.67	10.76	11.85
2 to 36	10.60	11.68		10.60	11.68	
37 or >	11.25	12.34		11.28	12.37	
Long Term Repriced						
1 mo. or <	10.00	10.79	13.15	9.74	10.47	12.89
2 to 36	10.36	11.15	13.53	10.10	10.31	13.20
37 or >	10.98	12.03		10.58	11.60	

In some cases, the rates shown are the average rate for several loan products within each loan type and associations within a district. As a result, some associations may have lower published rates for individual loan products than those listed above.

Definitions

Operating - < = 12 months
Int. Term - 13 months to 10 years
Long Term - > 10 years
Rates are adjusted for stock

JACKSON RATE COMPARISONS
12/31/87 AND 3/31/88

	FCS RATES 12/31/87			FCS RATES 3/31/88		
LOAN TYPE	LOW	AVG.	HIGH	LOW	AVG.	HIGH
Operating Repriced						
1 mo. or <	10.73	11.28	12.95	10.00	11.11	12.78
2 to 6				10.00	11.11	12.78
7 or >	10.78	10.78	13.00	10.00	11.11	12.78
Int. Term Repriced						
1 mo. or<	10.73	11.28	12.95			
2 to 36	11.56	11.56	13.78	10.67	11.78	11.78
37 or>	11.73	11.73	13.95	11.22	12.33	12.33
Long Term Repriced						
1 mo. or <	12.37	12.90	15.00		12.38	12.89
2 to 36	11.00	11.00	13.11	10.26	11.32	
37 or >	11.74	11.74	13.85	10.89	11.95	

In some cases, the rates shown are the average rate for several loan products within each loan type and associations within a district. As a result, some associations may have lower published rates for individual loan products than those listed above.

Definitions

Operating - < = 12 months
Int. Term - 13 months to 10 years
Long Term - > 10 years
Rates are adjusted for stock

ST. LOUIS RATE COMPARISONS
12/31/87 AND 3/31/88

	FCS RATES 12/31/87			FCS RATES 3/31/88		
LOAN TYPE	LOW	AVG.	HIGH	LOW	AVG.	HIGH
Operating						
Repriced						
1 mo. or <	10.78	12.37	13.67	10.61	12.08	13.67
2 to 6	10.78	12.37	13.67	10.61	12.08	13.67
7 or >	10.78	12.37	13.67	10.61	12.08	13.67
Int. Term						
Repriced						
1 mo. or <				10.80	12.29	13.67
2 to 36	10.78	11.89		10.65	11.95	
37 or >	11.22	12.33		10.72	11.84	
Long Term						
Repriced						
1 mo. or <				10.00	10.53	12.11
2 to 36	10.13	10.93		9.87	10.66	
37 or >	10.79	11.84		10.00	11.06	

In some cases, the rates shown are the average rate for several loan products within each loan type and associations within a district. As a result, some associations may have lower published rates for individual loan products than those listed above.

Definitions

Operating - <= 12 months
Int. Term - 13 months to 10 years
Long Term - > 10 years
Rates are adjusted for stock

ST. PAUL RATE COMPARISONS
12/31/87 AND 3/31/88

	FCS RATES 12/31/87			FCS RATES 3/31/88		
LOAN TYPE	LOW	AVG.	HIGH	LOW	AVG.	HIGH
Operating Repriced						
1 mo. or <	10.00	12.60	14.30	9.80	12.40	14.10
2 to 6	10.00	12.60	14.30			
7 or >	10.00	12.60	14.30			
Int. Term Repriced						
1 mo. or <	10.00	12.60	14.30	9.80	12.40	14.10
2 to 36						
37 or >				9.60	12.40	
Long Term Repriced						
1 mo. or <	10.26	11.42	12.60	10.30	11.43	12.65
2 to 36	10.52	11.84	12.89	10.50	11.85	12.95
37 or >	10.79	12.10	13.16	10.80	12.13	13.85

In some cases, the rates shown are the average rate for several loan products within each loan type and associations within a district. As a result, some associations may have lower published rates for individual loan products than those listed above.

Definitions

Operating - < = 12 months
Int. Term - 13 months to 10 years
Long Term - > 10 years
Rates are adjusted for stock

OMAHA RATE COMPARISONS
12/31/87 AND 3/31/88

LOAN TYPE	FCS RATES 12/31/87 LOW	AVG.	HIGH	FCS RATES 3/31/88 LOW	AVG.	HIGH
Operating						
Repriced						
1 mo. or <	10.76	12.09	15.15	10.77	11.55	15.16
2 to 6				10.33	11.11	11.66
7 or >				10.44	11.22	11.77
Int. Term						
Repriced						
1 mo. or <				10.77	11.55	15.16
2 to 36				10.83	11.61	12.16
37 or >				11.75	12.53	12.86
Long Term						
Repriced						
1 mo. or <	10.26	11.31	12.10	10.26	11.31	12.10
2 to 36	10.68	11.58		9.74	10.79	
37 or >	11.10	11.95		10.42	11.47	

In some cases, the rates shown are the average rate for several loan products within each loan type and associations within a district. As a result, some associations may have lower published rates for individual loan products than those listed above.

Definitions

Operating - < = 12 months
Int. Term - 13 mo. to 10 years
Long Term - > 10 years
Rates are adjusted for stock

WICHITA RATE COMPARISONS
12/31/87 AND 3/31/88

	FCS RATES 12/31/87			FCS RATES 3/31/88		
LOAN TYPE	LOW	AVG.	HIGH	LOW	AVG.	HIGH
Operating Repriced						
1 mo. or <	10.25	11.38	12.00	10.79	11.43	12.06
2 to 6	10.15	10.72	11.10	10.38	10.77	11.18
7 or >	10.20	10.75	11.08	10.40	10.82	11.18
Int. Term Repriced						
1 mo. or <	10.74	11.52	12.28	10.80	11.49	12.28
2 to 36	11.53	11.81		11.47	11.84	
37 or >	11.78	12.72		11.81	12.67	
Long Term Repriced						
1 mo. or <						
2 to 36	10.12	11.25	12.19	10.26	11.32	12.11
37 or >						

In some cases, the rates shown are the average rate for several loan products within each loan type and associations within a district. As a result, some associations may have lower published rates for individual loan products than those listed above.

Definitions

Operating - <= 12 months
Int. Term - 13 mo. to 10 years
Long Term - > 10 years
Rates are adjusted for stock

TEXAS RATE COMPARISON
12/31/87 AND 3/31/88

LOAN TYPE	FCS RATES 12/31/87 LOW	AVG.	HIGH	FCS RATES 3/31/88 LOW	AVG.	HIGH
Operating						
Repriced						
1 mo. or		11.43			11.26	
2 to 6						
7 or		11.65			11.04	
Int. Term						
Repriced						
1 mo. or		11.43			11.26	
2 to 36		12.60			11.54	
37 or		13.32			11.82	
Long Term						
Repriced						
1 mo. or		10.78			10.79	
2 to 36						
37 or					10.72	

In some cases, the rates shown are the average rate for several loan products within each loan type and associations within a district. As a result, some associations may have lower published rates for individual loan products than those listed above.

Definitions

Operating - = 12 months
Int. Term - 13 mo. to 10 years
Long Term - 10 years
Rates are adjusted for stock

The Texas district revised previously reported information and does not price loans on a differential basis.

SACRAMENTO RATE COMPARISONS
12/31/87 AND 3/31/88

LOAN TYPE	FCS RATES 12/31/87 LOW	AVG.	HIGH	FCS RATES 3/31/88 LOW	AVG.	HIGH
Operating Repriced						
1 mo. or <	10.84	11.79	13.56	10.74	11.84	13.64
2 to 6	8.62	10.69	12.51	8.10	10.73	13.10
7 or >	9.00	11.07	12.89	8.47	11.10	13.47
Int. Term Repriced						
1 mo. or <	10.84	11.79	13.56	10.74	11.84	13.64
2 to 36	9.78	11.84	13.67	9.14	11.78	14.14
37 or >	10.72	12.79	14.61	10.13	12.77	15.13
Long Term Repriced						
1 mo. or <	10.87	12.50	13.59	10.87	12.50	13.59
2 to 36						
37 or >						

In some cases, the rates shown are the average rate for several loan products within each loan type and associations within a district. As a result, some associations may have lower published rates for individual loan products than those listed above.

Definitions

Operating - < = 12 months
Int. Term - 13 mo. to 10 years
Long Term - > 10 years
Rates are adjusted for stock

SPOKANE RATE COMPARISONS
12/31/87 AND 3/31/88

LOAN TYPE	FCS RATES 12/31/87 LOW	AVG.	HIGH	FCS RATES 3/31/88 LOW	AVG.	HIGH
Operating						
Repriced						
1 mo. or <	9.95	12.06	13.75	9.24	11.03	13.91
2 to 6	9.95	12.06	13.75			
7 or >	9.95	12.06	13.75			
Int. Term						
Repriced						
1 mo. or <	9.95	12.06	13.75	9.24	11.03	13.91
2 to 36	9.95	12.06	13.75			
37 or >	9.95	12.06	13.75			
Long Term						
Repriced						
1 mo. or <	10.24	11.29	12.86	10.50	11.55	12.86
2 to 36	10.84	10.84		10.55	10.55	
37 or >	11.32	11.32		11.55	11.55	

In some cases, the rates shown are the average rate for several loan products within each loan type and associations within a district. As a result, some associations may have lower published rates for individual loan products than those listed above.

Definitions

Operating - < = 12 months
Int. Term - 13 mo. to 10 years
Long Term - > 10 years
Rates are adjusted for stock

On April 26, 1988 the Spokane district revised previously reported information. These revisions are included in this comparison and include:

1. Rates in the high category for operating and intermediate term loans for 3/31/88 were changed from 12.83 to 13.91.

2. Rates in all three categories for long term loans, repriced one month or less, were added for both 12/31/87 and 3/31/88.

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November 2, 1988

The Honorable David L. Boren, Chairman
Subcommittee on Credit
Committee on Agriculture, Nutrition and Forestry
United States Senate
453 Senate Russell Office Building
Constitution and Delaware Avenues N.E.
Washington D.C. 20510

Dear Mr. Chairman,

During testimony before your subcommittee in June 1988, Brent Beesley indicated that he would provide you with certain information on Farm Credit System foreclosure practices with distressed borrowers. Mr. Beesley had been asked to respond to the following (paraphrased):

> How frequently are foreclosure proceedings commenced during the time period commencing on the date of receipt of a borrower's request for a review by a credit review committee of an adverse loan restructuring decision and ending on the date the credit review committee's decision is sent to the borrower?

We have surveyed all twelve districts on this question and have found that the situation described virtually never arises.

It is also important to note that the Agricultural Credit Act of 1987 states the following in Section 4.14 A(b)(1)-(3):

> "(1) In general.--On a determination by a qualified lender that a loan made by the lender is or has become a distressed loan, the lender shall provide written notice to the borrower that the loan may be suitable for restructuring...
>
> (2) Notice before foreclosure.--Not later than 45 days before any qualified lender begins foreclosure proceedings with respect to a loan outstanding to any borrower, the lender shall notify the borrower that the loan may be suitable for restructuring and that the lender will review any such suitable loan for restructuring, and shall include with such notice a copy of the policy and the materials described in paragraph (1).

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(3) Limitation on foreclosure.--No qualified lender may foreclose or continue any foreclosure proceeding with respect to any distressed loan before the lender has completed any pending consideration of the loan for restructuring under this section."

Thus, the System is prohibited by law from initiating foreclosure proceedings during the restructuring request period provided for in the Act. If we can provide you with any further clarification of this matter or respond to any further questions, please don't hesitate to let me know.

Sincerely,

Jasper H Arnold III

Jasper H. Arnold III
Senior Vice President - Credit

JHA:bg

Senator BOREN. Thank you very much.

You commented about the capital structure and you said you had urged 4 percent as opposed to the 7 percent that the FCA has in their draft regulations which have been open to comment. Is that 4 percent more in line with what the other banking regulators and others are doing at this time?

Mr. EBERLY. That is correct. There are different ways that you can arrive at the figure, whether it is 4 or 7. We are not disputing that we do not need to have at the maximum capital we can have, but 4 percent is more in line with the provisions that we have now.

Brent, from a technical standpoint, you might have a comment on that.

Mr. BEESLEY. Mr. Chairman, currently the regulations for banks are higher than 4 percent, but they include in their capitalization their general reserves for loan losses. If we added those back into our capital ratios, we would be able to meet the 7 percent standard, but the new regulations that the FCA is promulgating restrict the use of the general reserves as part of capital and the banks are now considering also restricting the use of general reserve capital. Once they do that, they are planning to go to a 4 percent capitalization reserve.

Senator BOREN. So it is either 4 percent without being able to use the loan loss reserves in essence, or 7 percent with being able to use them, and so if you were to have a standard of 7 percent and not allow it, you would be having a higher standard for these institutions than you are going to have for the commercial banks.

Mr. BEESLEY. Mr. Chairman, we have been trying to make that point from the beginning. I am very pleased that you understand that.

Senator BOREN. I think that is a very important point. I happen to personally agree with your position. I cannot speak for the rest of the subcommittee, but I will endeavor to circulate a letter from the other members of the committee if that is also their view, because we are very alarmed at the stress that could put on the System and the pressure on interest rates again. If I find the other members of the committee agree with me, we will endeavor to circulate a letter getting members of the committee to sign it and to convey this view of the committee. I suspect it may be a unanimous view, and we will get it to the FCA.

Mr. BEESLEY. That would be much appreciated.

Senator BOREN. There is also the problem, as I understand it, of whether the local associations may pull out of the districts and join other districts, without the consent of the losing district, if it has a negative or an adverse financial effect on the district that is losing the local association. That is another problem that is now occurring, is that correct? Have you had any experience with that?

Mr. EBERLY. Mr. Chairman, that is correct, it is happening in the Wichita District or at least we have that concern that that may happen. We are hoping that certainly we read the bill to say that the regulator has the right to look at it and see if it is going to trouble the institution that is leaving, and obviously the institutions that have been talking about leaving the Wichita District, it will have an adverse effect on the credit bank.

Senator BOREN. Well, I think that is something else we have to look at, and I remember the compromise arrived at on that point in the conference committee, and that was exactly our intent in the compromise—that you would allow associations to leave a district and merge and enter into another district, but that there would have to be a very clear evaluation of this by the regulators to make sure that you did not create an adverse situation, because we could just cause all sorts of problems within the System if you have people starting to bail out to join other districts and then cause a district that is not in trouble to get in trouble as a result of that. That is something else I will endeavor to find out from the members of the committee and see if they share my view of this. It was certainly my understanding at the time that the FCA should exert its regulatory discretion to prevent that from happening if it would weaken the losing district, the district losing the local association. We will look into that.

I have a copy of a letter [1] that was sent from the St. Louis District to a borrower on an offer of settlement, and it says in this letter:

> It must be understood by all parties that any settlement offer reached will require you to forgive all rights under the Agricultural Credit Act of 1987. If a written response of acceptance to this offer is not received by Friday, April 29, 1988, this offer will be considered null and void. Federal land bank will then immediately obtain a judgment of foreclosure.

Now, is this a common practice among the System institutions, to ask for a full waiver of all rights under the Agricultural Credit Act of 1987 in order to reach a settlement?

Mr. BEESLEY. Mr. Chairman, let me just make one short statement of background and then answer your question directly. The System as a whole, that is, all of the presidents and the Board of Directors of the Farm Credit Corporation of America, adopted a policy on the borrower rights provisions of the law and the loan restructuring provisions of the law which, from what I understand, that those Members of Congress that have looked at it are very pleased that this policy incorporates both the spirit and the letter of the law.[2]

We have a problem in reconciling local control and autonomous units on the one hand and their desire to proceed in one way versus trying to get some uniform application of the statute. There is no widespread request as far as I know for this kind of thing, and those districts where I heard of this going on, I have contacted them and what they are saying is that they feel obligated to pursue the statute and all of the various checkpoints in the statute, and unless the borrower waives those, that as to deals that were pending, they feel the need to go back and start over pursuant to the statute, and that is the reason that in some isolated cases there have been requests for these types of waivers, so that they can get something done that has already been negotiated, without having to go back and work through the law. But it is usually a voluntary situation, and if the borrower says no, they do not want to waive it, then they would go back and do it pursuant to the statute.

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[1] See p. 565 for the letter.
[2] See p. 569 for the copy of the policy.

I think it is a transitional problem and has been basically in two districts where we have had most of these issues arise.

Senator BOREN. Well, I think it is something we need to work out, because the way that it is phrased appears to me, on the surface, to violate the spirit of the law, at least.

Mr. BEESLEY. What is the date of that.

Senator BOREN. This letter is dated April 20, 1988, from the St. Louis District.

Mr. BEESLEY. The St. Louis District had not endorsed the original system position and, as I understand it, in about that same timeframe, about the 20th of April, they did change their approach to certain aspects of the borrower rights provisions.

Senator BOREN. Well, I hope you convey to those districts where there are still some problems that that is something that the committee views with concern, and I think at the very least they should try to restrict what it is they are trying to avoid and not give this kind of a blanket comment of waiving all rights under the act.

I can understand how, if you have reached an agreement, if you accept it, the person cannot go back and ask for a full reconsideration, appeal or revaluation by the special asset group or something else, but I think this is overly broad and is something that we would have a concern about.

It is important that the copies of worksheets on the costs of foreclosure with all the calculations be available to the borrowers when we have a restructuring situation, because cost of foreclosure is one of those items that has to be considered in terms of whether or not it is cheaper for the System to abide by restructuring as opposed to a foreclosure action, you have to consider the cost of foreclosure. Is that made available to the borrower in terms of the review and appeals process?

Mr. BEESLEY. Mr. Chairman, the system policies on borrower restructuring have a lot of examples and a lot of detail to try to get uniform consistency. I could not remember specifically whether those calculations were provided. I have been informed today that they are not provided as part of that standard policy, although that is part of the proposed regulation that FCA has, but at this point—and I cannot remember this from my own recollection of the standards, but I am told that they are not provided.

Senator BOREN. Let me urge the System to look at that, because I think in all fairness, if the cost of foreclosure is one of those items that should be considered in terms of whether it is cheaper to restructure or to foreclose, that those costs of foreclosure, the worksheets on the costs of foreclosure, should be made available to the borrower; otherwise, he cannot really in a meaningful way protect his rights in any kind of review or appeal process.

Mr. BEESLEY. That would seem to make some sense to me as well, Mr. Chairman. I am sorry to be communicating with you in this way.

Senator BOREN. Not at all.

Mr. BEESLEY. Mr. Kirk informs me that in a review process they are made available, but let me look into that.

Senator BOREN. Well, it might be helpful if they were from the beginning, rather than just on the appeal process.

I have another question I want to ask and then I will defer to my colleagues. Is it the denial of restructuring, the decision to deny that triggers a foreclosure proceeding, or is it the denial of an appeal of that decision? Of course, if the restructuring is denied, there is the right to appeal. Now, is the foreclosure procedure triggered by the first denial, or is it triggered by the loss of the appeal of the denial?

Mr. BEESLEY. An appeal is filed and foreclosure would wait pending the outcome of that——

Senator BOREN. It would be held in abeyance. Is that the standard policy being followed in all the districts now?

Mr. EBERLY. That is the policy in Wichita District.

Mr. BEESLEY. When you ask if that is the standard policy being followed in all districts, it would be hard to say, particularly when you get down into all the 400 associations, but that is the intent and spirit of the Congress, as we understand it, and I would hope that that policy is being followed.

Senator BOREN. Well, again, we would certainly take a dim view if it is not, because, for one thing, when you go back and you figure the cost of restructuring, if you have already embarked upon expending some foreclosure costs, it would be absolutely wrong on the appeal to say, well, we can no longer consider the foreclosure costs to the System because they have already been expended, therefore if we restructure we would not save the foreclosure costs because we are already spending on the foreclosure. You know, if you commence foreclosure right after the first denial, before the appeal is heard, and then turn around and say to the farmer, oh, wait a minute, you cannot say it is cheaper to restructure because you saved the foreclosure costs, we have already spent the foreclosure costs, we have already got the foreclosure underway. You really would not be treating the borrower correctly in this situation.

Mr. BEESLEY. Mr. Chairman, I know that far too many incidents where it appears that the System is anxious to foreclose on somebody, and I deeply regret hearing that probably as much as anyone, but I think the numbers show that there is a sincere effort being made out there to restructure loans, with over 50,000 loans having been restructured since we started from almost a standing stop, where we had not restructured loans for 70 years. The culture of the Farm Credit System was when there was a default, which was very rare, to foreclose. We had no mechanism in place to do this.

The culture now in most every area is to do everything we can to restructure the loan and keep the farmer on the ground and I hope that is happening.

Senator BOREN. Well, is there any system or survey that you have that you could give the committee as to statistics for determining if in how many cases the foreclosure proceedings are being commenced prior to the determination of the appeal?

Mr. BEESLEY. That is not one of the elements that we have asked for reporting for, but we can make a special effort to find that out and report it to the committee.

[See page 343 for the material.]

Senator BOREN. I think that would be important. Would that be within the bounds of FCA regulations that could require that foreclosure procedures not proceed until appeal?

Mr. BEESLEY. I think that would be within their jurisdiction to require that.

Senator BOREN. One last quick question. When notice is being given of administrative proceedings, and so on, by certified mail, are we making sure that it goes to all borrowers, the wife as well as the husband, both spouses? Sometimes we have a situation where one spouse might not fully inform the other.

Mr. BEESLEY. I could not answer that directly. I would have to doublecheck. If the husband and wife are living together in the same home, I am not sure that they each get a separate notice.

Senator BOREN. But it would at least be addressed to both on the envelope?

Mr. BEESLEY. It probably would be addressed to Mr. and Mrs.

Senator BOREN. Yes, I think we need to check on that, because sometimes if it might have just went to Mr., Mrs. might not always be told and, you know, it is human nature sometimes, even within families, to not want to break the bad news to the spouse and they might find themselves in the situation that is tragic without their knowing about it.

Senator Karnes, questions?

Senator KARNES. I have no questions, Mr. Chairman.

Senator BOREN. Senator Exon, any questions?

Senator EXON. No, you covered all the questions I had, Mr. Chairman. Thank you very much.

Senator BOREN. Thank you very much. Thank you both very much.

Mr. EBERLY. Thank you.

Mr. BEESLEY. Thank you.

[The prepared statement of Mr. Beesley can be found on pages 262–285.]

Senator BOREN. We now have a panel and I apologize to members of the panel, we probably do not need to diet as much as I do anyway, in fact we have also caused them to be delayed in going to lunch.

Mr. Max Glenn, executive director of the Oklahoma Conference of Churches, whom I have had the privilege of knowing for quite some time; Mr. Jim Massey, executive director, Farmers' Legal Action Group, of St. Paul, Minnesota; Susan Bright, cochair of the Credit Committee of the National Save the Family Farm Coalition, Centerville, Indiana; Clayton L. Strebeck, associate area agent for farm management, Louisiana Cooperative Extension Service, Alexandria, Louisiana; and Eugene Severens, Center for Rural Affairs, Walthill, Nebraska.

We are very glad to have all of you join us. I am sure that several of the concerns you have are probably ones that have already been addressed during the earlier discussions, but we certainly do not want to short circuit the comments from those of you who are representing groups struggling to deal with the System, and we are very anxious to hear your perspectives on whether or not the spirit of the law is being carried out.

I do not know which one to begin with here. Oklahoma hardly ever defers to Nebraska, but out of kindness, looking to the usual record over the last decade in our football competition, I feel some sensitivity and kindness and deference is due just so to make them feel better.

Senator EXON. If you will hold that to the third Saturday of every November. [Laughter.]

Senator BOREN. So I believe we will begin with Mr. Severens, if you would like to begin with your comments and then we will follow along down the rest of the panel.

STATEMENT OF EUGENE SEVERENS, CENTER FOR RURAL AFFAIRS, WALTHILL, NE

Mr. SEVERENS. Your comment about maybe some of our points have been addressed by earlier testimony certainly applies to mine. In fact, a good deal of what I have stated in my prepared testimony has been somewhat moot by the announcement that Mr. Thor made, that the Omaha Farm Credit Federal Land Bank has asked for certification under section 6.4.

I would, nevertheless, like to have the prepared testimony entered into the record, along with its attachments, and instead——

Senator BOREN. We certainly will. Let me say that to all of you, because obviously, with the time as it is, there is no reason to go back over points that have been made or that are now moot. Feel free to raise the point if you would like to, and we will put everyone's full prepared statement in the record.

Mr. SEVERENS. Well, I was just going to ad lib, then, and make a few points. I do not think it will take too much time at all.

First of all, I am very impressed by the homework and the process that has been displayed this morning. I want to congratulate this subcommittee for the fine work it did, certainly on the certification issue. You knew that language down cold and you responded to all the points that were made, so I am very impressed by the process this morning.

I do want to say that the Omaha Federal Land Bank, as far as that issue goes and, for that matter, the demonstration project in all the eligible Federal land banks and the other district that might apply for certification, the certification is just really one step in the process. There needs to be a series of steps that have to be taken in order for the demonstration project and the other components that are packages of certification to get into effect.

So, I guess I would encourage this subcommittee to continue the fine work and scrutiny that you have done in the past to make sure that these steps are followed through, because there are many steps that we have to deal with.

Senator BOREN. Well, we intend to do just that.

Mr. SEVERENS. Great. Mr. Chairman, you had raised an interesting point, I think, when you discussed the interim period that we are in right now, the peculiar situation that we are in, with merger being just a few weeks away, and I thought I would just bring your attention to one thing, and this might also address Senator Karnes and I think other Senators' concern about taxpayer impacts of all of this.

While it is true, and I think quite clear, that a bank under the 75 percent level must apply for certification, section 6.4 needs to be read in conjunction with section 6.27, which is the actual issuance of preferred stock. As Senator Harkin said, the mays and shalls were discussed at some length, and while the shalls of certification are very clear, section 6.27 says each system institution that is certified under section 6.4 (a) or (b) may issue a special class of preferred stock only in an amount and subject to such terms and conditions as authorized by the system.

Senator BOREN. I think that exactly gets us out of the problem of having to issue unnecessary stock, but going ahead with the certification process.

Mr. SEVERENS. Right. And maybe, in light of the remarks that were made this morning, we may want to take a closer look at the statute, but I do not think we have ourselves in any kind of dilemma there. I think it is perfectly consistent that the Omaha Bank apply for certification and the decision be made on the issuance of preferred stock on the merits of that issue.

Senator BOREN. That is a very good point and we will call Mr. Thor and his general counsel's attention to what you just said, because I think you spell it out very well.

Mr. SEVERENS. To return just for a moment and continue these remarks, I just have a few points here. I wanted to say a few words about the demonstration project. Senator Harkin spoke about the demonstration project and, of course, it is now theoretically available or should soon be available in not only the Jackson District and the Louisville District, but also St. Paul and Omaha. So we are talking about a large part of the country that could have this demonstration project available.

It is a very unusual program. It is going to take two to tango on this, because it requires the cooperation of the Farm Credit System and the Farmers Home Administration, both. The program could become, you know, a victim of tokenism very easily. We could see the districts making a few loans, a couple of loans and that would be the end of it.

I think it is important that this particular program not have that happen to it, because the demonstration project is in effect the only viable Federal program available for helping efficient family size farmers purchase farmland at a time of comparatively low land prices.

In effect, the demonstration project is a chance of a lifetime, but it is a potential, runs the risk of being whittled away by the combination of aggressive land sales by the Federal land banks under the cover of long administrative delays, and those are two prongs that I would like to bring to the subcommittee's attention, aggressive land sales under the cover of long, unnecessary delays could simply mean that there is not going to be much inventory land or much less than the program actually authorizes available to be sold through the program. So that is one of the things that I would kind of leave the subcommittee with.

It is certainly not all over, but an important step has been passed this morning, but there are a number of steps ahead of us.

Finally, on a completely different subject altogether, a number of us in the Omaha District had been very pleased to be able to com-

municate with the Omaha Bank officials. We have met with John Martin of the bank on a couple of occasions and met with Mr. Kirk as well.

At our last meeting, held just this last Monday, a couple of points were made that I think I would like to bring to the subcommittee's attention. The main point is that while this is dealing with a subject of debt restructuring, while gross figures are kept as to what debts are restructured. I think for purposes of making the debt restructuring provision work well, what we really need to have is better data, for example, data on the number of applications that were received, the numbers that were turned down. It is very important that we get a handle on how debt restructuring works by having these kinds of figures available.

We are happy to say that in our conversations with Mr. Martin, I think there may be some progress in trying to resolve this, but it is really important. This is an important part of the act, and how it is actually playing out can be easily disguised under gross figures, without having a clear understanding in an individual way how the program is being implemented.

With that, I would just like to close my remarks and thank you once again for having this session and I applaud your scrutiny on this effort.

[The prepared statement, with attachments, of Mr. Severens follow:]

Testimony of
Eugene Severens
Center for Rural Affairs; Walthill, Nebraska

before the
U.S. Senate Agriculture Subcommittee on Credit
Washington, DC
June 16, 1988

Mr. Chairman, thank you for this opportunity to provide testimony on the Agricultural Credit Act of 1987. My name is Eugene Severens, and I am representing the Center for Rural Affairs, an unaffiliated, non-profit organization located in Walthill, Nebraska.

While there are many important implementation issues that our organization would like to raise before this subcommittee, I am going to focus on the delay in implementing SEC. 613 of the Act -- the "Demonstration Project for the Purchase of System Land" and the related issue of FCS Assistance Board certification (SEC. 6.4).

Background of the Joint FCS-FmHA Demonstration Project

The demonstration project is an innovative program designed to provide alternative methods of financing the sale of FCS institutions' farmland which was acquired through foreclosure and voluntary conveyance. Members of this Agriculture Committee may remember, during midwestern field hearings held in January 1987, being met with FCS advertising headlines like "Buy North Dakota." The demonstration project, which relies on the cooperation of FCS institutions and the Farmers Home Administration, was in part a response to these types of bulk sales.

The joint FCS-FmHA demonstration project was adopted unanimously by the Senate Agriculture Committee and subsequently by the House-Senate conference. It combines a number of related public purposes:

--provides a new source of buyer demand for acquired property for certified FCS institutions;
--reduces the need of distressed FCS institutions to resort to bailout assistance available through the issuance of preferred stock;
--provides new business opportunities for efficient beginning and re-entry farmers who cannot afford high downpayments;
--provides a new source of borrower-members for district banks, most of which had earlier experienced "borrower flight";
--reduces distressed institutions' need to resort to investor sales;
--experiments with a new, more controlled way of providing assistance to efficient family-size operations.

How the Demonstration Project Works

Mr. Chairman, I have attached to my testimony (attachment 1) a description of the demonstration project and would ask if it could be made a part of the record of my testimony. This description provides more information on the program's purposes, it describes how the program differs from other federal agricultural credit programs, and it provides a sample 7-

year payment schedule showing how the 5-year program can prepare a borrower for refinancing.

In a nutshell, eligible beginning and other family-size farm buyers would pay a 15% downpayment (compared to the current 30-50% downpayment for this type of borrower) and receive 4-percent interest assistance for five years from FmHA. To protect the financing institution from the risks involved in the low downpayment, they receive, also for five years, an FmHA 90% guarantee (or 95% if they contribute 1% to the interest assistance). Annual sales of $250 million dollars are authorized per year for three years (FY88-90). The guaranteed authority and interest assistance all came from existing authority.

Current Status of the Demonstration Project

Many of the components of the program are already in place.

** FmHA has set aside the necessary guarantee funds, and the administration has budgeted funds for the project.

** FmHA and the Farm Credit Administration (FCA) signed a joint memorandum of agreement on March 3 for implementing the project (attachment 2).

** Secretary Lyng (who is both charged by the law to "establish and carry out" the demonstration project and a member of the FCS Assistance Board) wrote Chairman Ed Jones of the House agriculture subcommittee on credit on April 20 assuring him both (1) that FmHA regulations on the demonstration project would be forthcoming soon and (2) that "the Assistance Board will take steps to make certain that those [certified] institutions participate in the Demonstration Project as required in Section 613(c)." (attachment 3).

Unfortunately, no land has been sold under the demonstration project to date. While the farmland is there and other components of the new law already implemented, this important program is languishing even at a time when many FCS institutions are stepping up land sales to investors and well-established farmers (see attachment 4). While a number of factors are contributing to this delay in implementing the program, we believe the main cause is the slowness in the "certification" of distressed FCS institutions by the FCS Assistance Board.

The "Certification" Issue

The demonstration project was intended to both provide new farming opportunities and reduce the need of distressed institutions to resort to financial assistance. Accordingly, the use of the demonstration project became tied to the Assistance Board certification process in which there are three main steps:

(1) application for certification; this is mandatory for institutions with stock value below 75% of par value and optional for institutions between 75% and 100%; Federal Land Banks in four districts are below 75%--Jackson, Omaha, St. Paul and Louisville.

(2) certification approval by the FCS Assistance Board; and

(3) if necessary, issuance of preferred stock under terms authorized by the Assistance Board.

These stages are described in more detail in attachment 5, but for purposes of this testimony, the important point is that certification is not the same thing as receiving federal financial assistance. The conferees' statement makes it clear that the certification stage, far from presuming financial assistance, is designed to avoid or reduce the need to resort to financial assistance. (Conference Report 100-490, pp. 183-186).

So far as we know, three of the four institutions which were required to have applied for certification have done so. The one hold-out is the Omaha FLB. Omaha officials argue that, because they don't plan to ask for financial assistance, they don't need to apply for certification. Our response to that argument is: if it's true they don't need assistance, more power to them, but that doesn't change the words of the law which say that they must apply for certification if the value of their stock is below 75%, and there is no argument over that point. They then argue that the law doesn't specify any time limit within which they must apply. This argument flies in the face of one of the purposes of certification which is to try and prevent the need for a financial bailout. The purpose of certification is a little like speeding laws which are designed to prevent accidents, and it seems to me that the Omaha officials' position is a bit like arguing that speeding isn't against the law until you hit someone.

The issue of certification is all the more serious when you take into account all the other provisions besides financial assistance that are tied into the certification process--and the demonstration project is only one of these. Recently, news reports have indicated that Omaha and Assistance Board officials are discussing certification for the "limited purpose" of participating in the demonstration project. We have not seen any documents relating to this certification, so we greet this news hopefully but cautiously. A limited purpose certification immediately prompts several questions -- in particular, does the Assistance Board have authority to limit the use of other provisions which are an integral part of certification?

Delay Reduces Potential of Demonstration Project

At the very time the use of the demonstration project is held up by certification delays, FCS insitutions are rapidly selling down their inventories. The Omaha district's inventory is down to about $70 million, and with recent aggressive sales campaigns there is a net reduction in the value of inventory of about 10% per month. Even the district with the largest inventory, St. Paul, the inventory is down to $144 million. The demonstration project allows the sale of $250 million per year for the next three years, but there seems little chance of realizing that potential for FY1988. And, if aggressive land sales continue under cover of administrative delays in making the demonstration project available, the potential for the next fiscal years will also suffer.

Mr. Chairman, the demonstration project is, in effect, the only viable federal program available for helping efficient family-size farmers purchase farmland at a time of comparatively low land prices. This program is the chance of a generation, and its potential is being whittled away. We need to get it up and running immediately. Thank you for this opportunity to provide testimony.

Attachments 1-5 follow:

Attachment 1

FCS REPORTER

FCS Inventory Re-Sale Program

Financing Family Farm Rebuilding

On December 18, 1987, Congress passed, and the president signed into law, the Farm Credit Act Amendments of 1987. One important, but little reported, provision of the law was the creation of a "demonstration project" for selling FCS inventory farmland to family-size farmers. This project, the result of the efforts of Senate Agriculture Committee Chairman Patrick Leahy (D. Vt.), would achieve a number of related public purposes:

--provide farmland purchase opportunities for beginning farmers and those who are expanding to family-size operations;

--provide immediate assistance to distressed FCS institutions by providing a new set of buyers for FCS inventory land;

--rejuvenate local associations' membership by providing a new set of potential family farm stockholders;

--help stabilize farm land values;

--rebuild family farm-based rural economies and prevent unnecessary out-migration of farm families;

--develop a new mechanism for encouraging appropriate conservation practices on FCS inventory land;

--demonstrate a different model for providing farm ownership credit that clarifies the limits of both the government's and the borrower's commitments and expectations.

At the heart of the program is a five-year period of 4% interest assistance from FmHA for eligible family farmers to purchase FCS inventory property. A 90% FmHA loan guarantee comes with the 4% interest write down, and the package is then linked up with a private lender or FCS institution which finances the land purchase. Qualifying farmers must make a 15% downpayment on the FCS land, and after 5 years, the borrower will be required to "graduate" to commercial financing.

The demonstration program would last for three years and require that the Farm Credit Administration and FmHA develop a joint memorandum on how to implement the program. FCS institutions would be authorized to sell $750 million worth of property through the program over the three-year period (FCS inventory is valued at $1.1 billion by the October Farmline magazine).

Required Graduation

Fiscal considerations made it imperative to consider an ending point for any federal interest assistance for targeting the sale of FCS inventory land, and required "graduation" to a commercial lender after five years. The borrower must refinance the loan at the end of the five years.

Graduation is also a part of direct FmHA programs, but it occurs "cold turkey" with little, if any, advance planning to make the transition easier. In the case of this special program, however, graduation should be feasible since other components of the program are designed to smooth out the transition from program financing to commercial credit. Where graduation is carefully planned for, it can both give participants realistic expectations and define the limits of the government's involvement in a loan.

This demonstration project contains a number of elements which make graduation feasible:

(1) The borrowers' fifth year equity position will rise from 15% (the downpayment) to over 28% during the 5-year period (see example below), placing the borrower's new equity position at the end of the fifth year within both current FCS limits and those legally required (20% minimum) for the proposed secondary market for agricultural mortgages. If land values appreciate, the borrower's equity position would increase even more.

(2) While it is difficult to predict interest rates five years away, based on today's rates, the farmer's effective interest rate will rise by approximately 5% after graduation. Assuming the refinanced loan were amortized over 30 years, the new annual payment would increase less than 11% (from $7411 to $8279, see example below).

(3) A five year record of debt payment and equity increase will provide an important indication to a commercial lender of likely continued success.

Will It Work?

A key question, of course, is will this program really be used? At least two recent federal credit programs, which relied on an FmHA guarantee to induce a partnership between the

to page 14

from page 12

federal government and private lenders, have failed to generate much participation.

One program was the administration's FmHA debt adjustment program (DAP). It offered an FmHA guarantee to private lenders who would voluntarily rewrite bad loans by either writing down the principal or reducing the lender's interest rate. When few lenders found this program attractive enough, Congress created a new program. This second attempt borrowed the basic guarantee approach but sweetened it with an interst "buy-down" which offered a 2% federal interest subsidy to match a lender's 2% itnerest write-down. Even this 2% buy-down on top of the guarantee failed to attract much interest. Of the $490 million appropriated for interest buy-down back in 1985, very little had been used through FY 1987, reportedly because lenders were reluctant to lose the income represented by the 2% write down.

Both of these programs were dependent upon lenders' voluntary involvement, which never materialized. A serious flaw in any guarantee approach is that, unless you provide just the right kind of "carrot," private lenders can completely frustrate the program's intended benefits.

The new demonstration project is different from these two programs in a number of important respects. First, unlike the earlier DAP and buy-down programs, the demonstration program offers the lender a federal guarantee without requiring the lender to write down interest rates. The guarantee is best viewed as the extra protection needed to allow the lender to make a loan on the basis of the low 15% downpayment.

Second, these guarantees are not used for re-writing troubled loans, but are for brand new loans. The sale of FCS inventory property will involve a new set of parties and a new calculation of loan viability.

Third, these guarantees are not for operating loans but for real estate loans. With the farmland as collateral and with land prices appearing to stabilize, these loans are less risky.

Fiscal Costs of the Project

The program is designed so that FCS institutions can sell up to $250,000,000 of inventory per year for three years through this special program. The budgetary impact will be limited to the costs of the interest rate assistance. Money for this assistance comes from funds appropriated for the unused buy-down program described above. In addition, the sales of FCS inventory land facilitated by this demonstration project reduces the need for general bailout funding.

If the full $750,000,000 worth of FCS inventory land is sold through the demonstration project, the total cost of the interest rate assistance would be $120 million spread out over seven years. <>

EXAMPLE OF HOW THE FCS INVENTORY RE-SALE PROJECT WOULD WORK

This example assumes a purchase of inventory property worth $100,000; a downpayment of 15%; a loan for $85,000 amortized over 20 years with a balloon payment to be refinanced with a commercial lender after five years; and a borrower interest rate of 6% with government assistance of 4%.

Year	Farmer's total payment	Farmer's interest payment	Farmer's principal payment	Loan balance (equity)	Govt's interest assistance
1	$7,411	$5,100	$2,311	$82,649 (17%)	$3400
2	7,411	4,961	2,449	80,239 (20)	3308
3	7,411	4,814	2,596	77,644 (22)	3210
4	7,411	4,659	2,752	74,892 (25)	3106
5	7,411	4,411	2,917	71,974 (28)	2997

After the fifth year, borrowers would have to graduate to commercial credit (assumes refinancing at 11%, 30 year amortization, no change in land value):

6	8,279	7,917	362	71,613
7	8,279	7,877	401	71,211
. . .				

Attachment 2

MEMORANDUM OF UNDERSTANDING BETWEEN
THE FARM CREDIT ADMINISTRATION AND THE FARMERS
HOME ADMINISTRATION REGARDING THE DEMONSTRATION PROJECT
FOR THE PURCHASE OF FARM CREDIT SYSTEM LAND

Section 613(c) of Public Law 100-233, the Agricultural Credit Act of 1987 (1987 Act), amends Section 351 of the Consolidated Farm and Rural Development Act, 7 U.S.C. §1999, by adding Subsection (h) which provides for the establishment of a Farmers Home Administration (FmHA) 3-year Demonstration Project (Demonstration Project). The Demonstration Project provides FmHA guarantees and interest rate reductions on loans to eligible applicants for the purchase of land owned by Farm Credit System (System) institutions certified by the Farm Credit System Assistance Board to receive assistance.

In addition, Section 613(c) of the 1987 Act requires the Secretary of Agriculture (Agriculture) and the Farm Credit Administration (FCA) to develop a joint Memorandum of Understanding governing the implementation of the Demonstration Project. Therefore, the following constitutes the agreement between Agriculture and the FCA relative to the Demonstration Project.

1. The FmHA will determine eligiblity of applicants for the Demonstration Project and will provide, to the extent practical, financing from funds available for guaranteed farm ownership loans.

2. The FmHA will monitor the Demonstration Project and prepare monthly reports as to the loan activity generated by the Demonstration Project.

3. The FCA through its regulatory, examination and supervisory powers, will monitor compliance with the provisions of the 1987 Act relating to the Demonstration Project that are applicable to System institutions. Such provisions require certain System institutions: to sell land to eligible borrowers under the Demonstration Project at fair market value; to the extent practicable, to set aside each fiscal year land in an aggregate amount not to exceed $250 million for purchase by eligible borrowers; and, if necessary, to subdivide tracts of land into parcels permitting borrowers to purchase land within the restrictions placed on loan size by law.

4. The FCA, upon request of FmHA, will provide technical assistance to the extent possible in connection with the implementation of the Demonstration Project.

5. The FCA will notify the FmHA, to the extent FCA has been so advised, of System institutions certified to issue preferred stock under Section 6.4 of the Farm Credit Act of 1971, as amended.

6. The FCA and FmHA understand the following regarding the Demonstration Project established by the 1987 Act:

   - Loan guarantee applications will be processed in accordance with FmHA regulations, including those set out in 7 C.F.R. Part 1980 Subparts A and B.

   - Properties listed under the Demonstration Project will be disposed of in a manner consistent with the applicable provisions of Section 4.36 of the Farm Credit Act of 1971, as amended by Section 108 of the 1987 Act, governing the rights of first refusal of former owners.

This Memorandum of Understanding is effective upon signing by both the Chairman of the FCA Board and the Administrator of the Farmers Home Administration and may be amended at any time by agreement of both parties, and shall terminate with the expiration of the authority for the Demonstration Project.

By: Vance L. Clark, Administrator
Farmers Home Administration

Date 3.3.88

By: Frank W. Naylor, Jr., Chairman
Farm Credit Administration

Date 3-3-88

Attachment 3

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D C 20250

APR 2 0 1988

The Honorable Ed Jones
Chairman, Subcommittee on Conservation,
Credit, and Rural Development
Committee on Agriculture
Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

I am pleased to respond to your letter of April 11, 1988, in which you request a written statement addressing implementation of a three year "Demonstration Project for the Purchase of System Land" authorized in Section 613(c) of the Agricultural Credit Act of 1987 (the Act). I request that this letter be made part of the official hearing record.

In accordance with the law, I have directed the Farmers Home Administration (FmHA) to promulgate regulations which will implement this section. FmHA has developed the regulations and is in the process of obtaining clearance from the Office of Management and Budget (OMB). Once this clearance is obtained, the regulations will be published as a proposed rule, providing for a 30 day public comment period. As soon as the 30 day comment period is completed and FmHA has considered concerns expressed by the public, the regulations will be finalized. FmHA will work closely with OMB to try to minimize the OMB clearance time so that the final rule can be implemented as quickly as possible.

The law also required that FmHA and the Farm Credit Administration (FCA) enter into a memorandum of understanding governing the implementation of Section 613(c). This memorandum of understanding was completed on March 3, 1988. A copy is enclosed.

FmHA has also provided its field offices with a memorandum regarding the provisions of the Demonstration Project to assist them in replying to any questions which the public might have regarding the project. A copy of this memorandum is also enclosed.

Section 613(c) provides that FmHA eligible borrowers may obtain certificates of eligibility to be used to obtain a loan for the purchase of property at the reduced rate of interest authorized by Section 1320 of the Food Security Act of 1985 from any legally organized lending institution or FCS institution. The property to be purchased must be owned by Farm Credit System (FCS) institutions that have been "certified to issue preferred stock" by the Farm Credit System Assistance Board (Assistance Board).

Pursuant to the Agricultural Credit Act of 1987, the Assistance Board may certify an FCS institution to issue preferred stock if the book value of its stock is below its par value. If an institution's stock is not valued below par, it may not be certified by the Assistance Board. Furthermore, an institution is required to seek certification only when the book value of

its stock is 75 percent or less of the par value. You suggest that the Assistance Board may certify an institution for purposes other than eligibility to issue preferred stock, such as certification for purposes of participating in the Demonstration Project: however, Section 613(c) expressly states that the Demonstration Project is confined to those "institutions of the Farm Credit System certified to issue preferred stock under section 6.27 of the Farm Credit Act of 1971." For institutions that have or will be so certified, I can assure you that the Assistance Board will take steps to make certain that those institutions participate in the Demonstration Project as required in Section 613(c).

Sincerely,

Richard E. Lyng

RICHARD E. LYNG
Secretary

Enclosures

Note: Enclosures do not print.

Star Tribune
Wednesday
March 16/1988
1D.

Attachment 4

FCS sets big sale of land to partners

Legislative bill could halt deals

By Sharon Schmickle
Staff Writer

An investment partnership group based in southern Minnesota has agreed to buy 133 farms encompassing 20,761 acres of land from Farm Credit Services of St. Paul (FCS).

The deal, made public Tuesday by FCS President Larry Buegler, comes as the Minnesota Legislature is considering a measure that would set a 1,500-acre limit on the farm land any one investment partnership can own.

The group has offered $13.5 million cash for properties spread over 29 counties, according to Dave Kettering, an FCS vice president. A farmer-owned firm, Arends Farms Inc. of Laverne, Minn., would be the general partner and bring three limited partners into the deal, Kettering said.

Closings can't start until former owners, who lost the property through foreclosure or restructuring of delinquent debts, have a chance to exercise a "right of first refusal." Under state law, former owners may buy land back at its appraised value within 65 days of receiving a notice that a sale is being considered.

Under an agreement with FCS, the buyers intend to offer three-year leases to the current operators of the farms, said Layton Hoysler, FCS director of acquired properties.

"Their goal is not to farm the land themselves but to rent it out to the local farmer," Hoysler said.

The deal would be the largest sale by the FCS to a single buyer or investment group. Some of the parcels have been in the FCS inventory for as long as 18 months. Many carry a "land-value guarantee" provision under which FCS pledged, during a sales promotion last year, to refund the purchase price if the buyers want to return the land within five years.

The owners of Arends Farms, two brothers who farm near Laverne, could not be reached for comment yesterday.

Farm credit Continued from page 1D

Closings of sales are likely to start in early April, Kettering said.

But the prospective buyers might be racing the Legislature. Bills expected to be considered by the Senate Agriculture Committee today and the full House of Representatives sometime this week would limit partnership holdings of farm land effective May 1. FCS officials said much of the land included in the purchase agreements cannot be sold until after May 1.

Another recent proposal to sell 4,340 acres of Red River Valley crop land to investors through a limited partnership drew strong opposition from advocates of the family farm. The Minnesota Farmers Union is one of several groups lobbying intensely for legislation to block such deals.

However, some agricultural economists and many farmers think agriculture and beleaguered farmers would benefit if investment capital is pumped into the industry.

The issue has come up now because a widespread restructuring of farm land ownership is underway. Lenders have recently repossessed millions of acres in the Upper Midwest and are trying to sell the property. FCS, the state's largest farm lender, alone sold more than 800,000 acres last year in Minnesota, Wisconsin, North Dakota and Michigan.

Rep. Elton Redalen, IR-Fountain, questioned Buegler about large sales to investors after Buegler made a speech yesterday before an agricultural issues luncheon sponsored by the University of Minnesota. Ninety percent of the FCS land has been sold to farmers, Buegler said.

"It is not any intent of ours at this point to make bulk sales of real estate," he said. "These deals just happened to come along."

Redalen said yesterday that he has voted against the pending legislation because he thinks farmers need opportunities to bring outside investors into their operations. But yesterday's disclosure might change his mind, he said. Redalen, a farmer, said he is concerned that some farmers might be displaced by such large deals and that land prices might be driven beyond the reach of many farmers.

Legislators also have questioned the role that Hoysler and Associates, a real estate sales and consulting firm, has played in the deal. Layton Hoysler said that he sold his interest in the firm after he started working for FCS in early 1987, but that his son is a part-owner of the firm. The investment partnership hired the firm to evaluate farms for sale before making an offer to FCS.

Rep. Charles Brown, DFL-Appleton, met with FCS officials yesterday to question links between Hoysler and the deal. "Based on the information that I received at the meeting, I am convinced there is not a conflict of interest," Brown said.

Kettering agreed: "The partnerships are the ones that have hired Hoysler and Associates. We have no connection with that firm. We do no business with them."

Attachment 4--Continued

Farmland Investor Fair IV set March 23

CHICAGO — Hugh T. Martin of The Chicago Farmers and Steve Lage of the Farm Credit Banks have announced that the Farmland Investor Fair IV is set for March 23 at the Bismarck Hotel in downtown Chicago.

The Chicago Farmers will be joined this year by the sixth district Farm Credit Banks to bring farmers, investors, farm and financial managers and realtors together to discuss farmland investment opportunities.

Lage, director of Illinois properties with the Farm Credit Banks, said, "The Farm Credit Banks joined The Chicago Farmers to make this the most comprehensive fair possible. It is designed to meet the needs of farmers seeking investors; investors seeking farm opportunities; and to bring together experts on every aspect of farming to advise both the novice and sophisticated investor."

The fair will include a mornign session to focus on the essentials of farmland investment. This will be followed by individual presentations on management of land, financing the purchase and information for first-time land owners. Starting at 2 p.m., individuals will attend the fair, where 100 exhibitors will display their diverse offerings of land, limited partnerships and other farm ventures. Exhibits will include where to find properties, what to look for when buying land and financing the purchase.

"Recent news items tell of major agricultural funds being started so that small investors can diversify their portfolios without buying the whole farm," Martin said. "Several of these firms will be present to tell their story. The Chicago Farmers office has been receiving calls from all over the country. Every day, inquiries are made from farmers who want to work with investors and individuals who would like to invest in farming."

Martin and Lage agree that the interest in farmland has increased because many market analysts believe that land prices have already or will soon, hit bottom. "Many investors are investing in land to diversify their portfolios and are looking for stability that the stock market is not offering at this time," Lage stated.

The Chicago Farmers is a 52-year-old club devoted to the advancement of agriculture and located in the heart of the world's agricultural center — Chicago. The club is comprised of 600 members from all aspects of farming: farm owners, producers, processors, commodity traders and suppliers to the agricultural industry.

The Sixth District Farm Credit Banks is part of a nationwide system consisting of borrower-owned financial institutions and related service corporations. The district banks make loans to farmers in Illinois, Missouri and Arkansas through local farm credit services offices.

ILLINOIS AGRI-NEWS
MARCH 11, 1988

Attachment 5

"Demonstration Project" Technical Hang-up

Section 613(c) of the Agricultural Credit Act of 1987 creates the "demonstration project for the purchase of system land." For a description of how the project works, see (or write us for) the Fall 1987 issue of the Advocate. Project implementation now awaits regulations, but in the meantime, a technical problem has developed.

The project is designed to limit participation to distressed FCS institutions defined by the statute as those that are "certified" by the new Farm Credit System Assistance Board to issued preferred stock. In other words, participation in the demonstration project is keyed into the financial bailout mechanism. Certification is basically a three step process:

Step 1: Distressed institutions apply for certification to the Assistance Board. Institutions with stock valued at less than 75% of par value must apply for certification. Those with stock valued under 100% but over 75% of par value may apply.

Step 2: The Assistance Board approves or disapproves the application for certification. The legislative history indicates that the Assistance Board is expected to certify institutions below 75%. A certified institution does not necessarily receive bailout funds (Step 3); but step 2 does invoke special powers of the Assistance Board over the certified institution. The legislative history also assumes that the Assistance Board will explore all "non-cash assistance" before resorting to the "cash assistance" of step 3. Use of the demonstration project is an example of non-cash assistance.

Step 3: This step is the government financial bailout. The Assistance Board determines that the certified institution needs "cash assistance" and authorizes the institution to issue preferred stock. This stock is bought by a newly created bailout entity (the "Financial Assistance Corporation") which raises funds by selling separate, taxpayer-backed bonds.

The management of many distressed institutions are apparently attempting to delay or avoid certficiation because they are apprehensive about being under the special powers of the Assistance Board. Even instititions under the 75% threshold (see Step 1), are arguing to delay certification. This prevents them from participation in the demonstration project. Officials from one district bank have indicated they would like the option of using the project but not at the cost of being subject to the powers of the Assistance Board.

This result is illogical and unnecessary. It's illogical because the demonstration project goes untested while institutions interested in using the project can't because of unrelated fears of Assistance Board powers. The result is unnecessary because the newly created scheme provides adequate flexibility to avoid this problem.

As the legislative history shows, the certification process deliberately makes a key distinction between certification approval ("Step 2" above) and the issuance of stock ("Step 3") so that all "non-cash assistance" can be utilized to avoid the necessity of stock issuance. The Assistance Board has the authority and responsibility to avoid stock issuance by designing (and, as conditions change, altering) non-cash assistance: it can, among other things, encourage use of the demonstration project while at the same time explicitly refrain, at least temporarily, from the use of other more drastic methods.

There is no reasons that well-designed Assistance Board responses to certification requests cannot prescribe appropriate forms of assistance and relieve the fear that the Assistance Board is going to sweep in with its full scope of special powers. At any rate, for those institutions where stock has fallen below 75% of par value, they have already applied for certification and should quickly certify these institutions at least for the purpose of encourging use of the demonstration project. <>

Senator BOREN. Thank you very much, Mr. Severens.

Let me ask my colleagues, I do not know what their schedules are, if they have any questions, my colleagues from Nebraska.

Senator EXON. Could I have 30 seconds?

Senator BOREN. Certainly.

Senator EXON. I have an appointment at 1:35 that I want to keep. I want to get back to hear the other testimony. I just want 30 seconds to thank you for coming, Mr. Severens. Had we known what we found out this morning, I would not have invited or insisted that you come in and make your appearance here today.

I just want to say, Mr. Chairman, that were it not for the spark that Mr. Severens, who is connected with our truly great organization, the Center for Rural Affairs in Walthill, Nebraska, this matter probably would never have come up with regard to the demonstration project and the critical need that we have for that in Nebraska. I thank him for bringing it up. I salute you for your efforts and thanks for coming in. We have taken a significant step forward with the certification which at least allows things to begin to happen.

I also compliment you for saying that there are things that have not been accomplished. We will be following through and will be continuing to check with you. Thanks for coming.

I thank the other members. I will get back as soon as I can.

Senator BOREN. Thank you very much, Senator Exon.

Senator Karnes.

Senator KARNES. Thank you, Mr. Chairman. I too would like to echo the remarks of my colleague from Nebraska and compliment Mr. Severens. Gene and I and my staff have had a chance to talk on several occasions about issues of great importance to Nebraska. I think one of the things that we need to underscore at this point in time, Mr. Chairman, is our work is indeed only partially done. We need to make sure that the Department puts together their regulations in a timely fashion. We need to have those regulations out there so the demonstration program can move ahead during this period of time when we have land available. Many people that are very interested in increasing the size of their farming operations, hopefully family-size farming operations, and also we want to encourage younger farmers, who now have an opportunity they have not had in recent memory and may not have in the future. An opportunity to secure financing at rates that are very attractive and may allow their operations to cash-flow. We have heard a bit, and I know the chairman has participated in some of those discussions, about an emerging weather situation in our part of the country. We need to make sure that we are mindful of the stresses that may come from that and the additional pressure that is placed upon our farmer families because of that situation.

I would like to just make a point here that I will be making contact with the Department of Agriculture. We must make sure that they get these regulations in place and we do not wait until the middle of the fall before regulations actually do come down. It would cut the heart out of the demonstration program, which my predecessor was so very interested in. I know he would very much have liked to see the entire program in place, including the regulations, right now.

That is something I know I share with all of my colleagues on this committee. I again compliment my fellow Corn Husker and fellow Omaha Bentsen High School graduate for his fine testimony and his fine advocacy for the Center for Rural Affairs for agricultural interests.

Senator BOREN. Thank you very much, Senator Karnes.

Again, I add my thanks to you for being here. The Center has been very helpful to me in providing me with ideas and suggestions over a long period of time, and I am very appreciative of that.

Ms. Bright, we are very happy to have you with us and we would welcome any comments that you might like to make and we will receive your full prepared statement for the record.

STATEMENT OF SUSAN BRIGHT, COCHAIR, CREDIT COMMITTEE, NATIONAL SAVE THE FAMILY FARM COALITION, CENTERVILLE, IN

Ms. BRIGHT. Thank you. I have one other request. We have our comments submitted to the FCA on their proposed borrowers' rights regulations. I would like to ask for it to be submitted for the record also.

Senator BOREN. We would be happy to receive those comments for the record.

Ms. BRIGHT. Thank you. I will try to keep my comments much shorter than I originally intended. It is hard. I talk a lot.

First of all, if you want to really hear what is going on out there with FCA and the Farm Credit System, we urge you to take this hearing into the field, if that would be possible. It is awfully expensive and it is awfully hard for farmers to get to Washington.

Senator BOREN. Yes, ma'am.

Ms. BRIGHT. The thing that I want to hit today, and you have already alluded to it and I appreciate that, is the calculations. As farmers trying to restructure we desperately need the calculations used to determine the cost of foreclosure or restructuring. To demonstrate the kind of problems that we have had in the past is in January 1987 our family was trying to negotiate with the Federal land bank. We were not asking to forgive any debt, simply to let us make up the payment that we had missed, and we had a positive cash-flow, we had everything to show that we could do it. All we were asking for was a chance, and when we asked for their calculations they kept saying it will not work, it will not work. We said show us, show us where it will not work, and the man finally sat back in his chair and he said, "OK, we choose not to do it," and we think that is not consistent with good business decisions, and that is what this law and this subcommittee has worked so hard on, and that is why the calculations are very, very necessary.

In our comments to FCA, we have a whole grocery list of forms, of calculations that should be available to the farmer.

Senator BOREN. Good, that should be available.

Ms. BRIGHT. These calculations should be available up front. The proposed regulations state they will submit to you a name of someone who can give you those calculations. This is extra bureaucracy, it takes time, it costs money. We would ask that those are documentations, it is just good business that those be available up front.

Senator BOREN. That is a good point. Let me say to the staff listening to this, we will go over this list that you supplied for the record very carefully, and what I intend to do is circulate a letter that hopefully will be signed by all members of the committee to be sent to the FCA in which we will spell out some very specific suggestions of things we think should be in the regulations, and we will pay very close attention. We will make some very specific suggestions in regard to calculations in that letter.

Ms. BRIGHT. Thank you.

The other thing I would like to comment on, I learned something here today about Louisville, which is the district that I live in, and I have a question as to why did their interest rates go up half a percent after they were certified. You do not have to answer. I just think that is interesting.

Senator BOREN. I do not know the answer to that myself.

Ms. BRIGHT. All right, nobody seems to know.

The other thing, again referring to previous comments here today, is the furnishing—and I know that we all chuckled about the rugs and this kind of thing, but in Scottsburg, Indiana we have an office that has a chandelier that supposedly cost somewhere above $100,000. Now, at $500 an acre, a 200-acre farm in Scottsburg area is what we are talking about here, and yet it seems to us that the attitude of the officials, the local officials, all the way to Louisville seem to be to sort of slough this off, and yet when you take a farmer on 200 acres that gets delinquent, they do not want to slough that off.

Senator BOREN. Would you send me a photograph of that? I would be happy to receive it, if you could get one.

Ms. BRIGHT. Okay, I will——

Senator BOREN. If they will let you in to take the photograph——

Ms. BRIGHT. I do not know.

Senator BOREN [continuing]. Or if you can find somebody who could go in and give us an appraisal on that, I would like to have it.

Ms. BRIGHT. That is just one thing. There are other things. Like you said, there are empty nails and people—and farmers have been asking about this for a long time. You know, they have been accused of being bad managers, driving the wrong kind of tractor, buying a new pickup truck every 5 or 6 years is, you know, not good management, and yet you go into the office, the most recent land bank office I was in, I asked to go to the bathroom and the wallpaper in that office I recognized because I have been shopping for wallpaper, it is very expensive and it is brand new. The towels are monogrammed in the women's bathroom in the Farm Credit System, who brag about not having very many women in their System, therefore I could do without these. These kind of things farmers see and they feel very offended by it.

Senator BOREN. You know, farmers are going to have to participate very fully in these local elections, the election process of board members, and they are going to have to start calling their board members to account. The farmer representatives on these boards ought to go in and stop the extravagances.

Ms. BRIGHT. That was my question, if I would have been allowed to ask, is who were the farmers that the Assistance Board talked to

from the Louisville District when they were putting together all of this plan. We in the Indiana Rural Crisis and the Farm Coalition have developed what I think are quite good communications with the Louisville people—and I say this very candidly. Yes, we can talk and we are friendly, but we have not gotten anywhere on these calculations and that is a real problem.

Now, once we start getting somewhere, then I would say it is fruitful. Right now it is just nice to visit with them, but it has been hard to see any results.

Senator BOREN. If we can get the regulations in place, then they will have to follow the regulations.

Ms. BRIGHT. My last comment, and forgive me if this is cynical, but when talking about Mr. Watkins, the receiver in Jackson, his problems, his personal problems, it is all fine and good to say, well, we do not want to harm anybody, but a farmer with that same kind of a problem would hardly get an application, let alone listen to his restructuring policy. I think these are the kinds of inconsistencies that the farmers are seeing and that I see and that I would like to bring to your attention.

That is all fine and good that we treat Mr. Watkins with all due respect, but I think we have got a lot of hard-working farmers out there that deserve the same kind of respect that everybody else does from here on out.

Senator BOREN. I agree. I feel that very strongly. All I was saying in my comment, because I was the person who called some of the problems to the attention of the FCA and asked for an explanation, was that we should never prejudge anybody, a farmer should not be prejudged either.

Ms. BRIGHT. Right.

Senator BOREN. That is all I was saying, but there has to be a thorough inquiry into this by the FCA and we expect a report back and we have asked for it today.

Ms. BRIGHT. And farmers should have a thorough look. It should be a very serious attempt at their restructuring also.

Senator BOREN. Absolutely.

Ms. BRIGHT. I could say lots more things, but I will be quiet now. Thank you.

[The prepared statement and attachments of Ms. Bright follow:]

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TESTIMONY OF SUSAN BRIGHT
ON BEHALF OF THE NATIONAL SAVE THE FAMILY FARM COALITION
BEFORE THE SENATE SUBCOMMITTEE ON AGRICULTURAL CREDIT
JUNE 16, 1988

I would like to thank the Subcommittee for allowing me to be here today on behalf of the National Save the Family Farm Coalition (NSFFC). We are a coalition of 46 member organizations in 32 states. I am Co-Chair of the Credit Committee whose goal is improving credit conditions for family farmers. I farm with my husband and 3 children near Centerville, Indiana.

Throughout the legislative debate, the Coalition worked with you to ensure that the Agricultural Credit Act of 1987 was not just a bailout of the Farm Credit System but addressed real needs of its member/borrowers to strengthen everyone involved with the Farm Credit System. Farmers are still waiting for these reforms to become a reality.

Many farmers have expressed their concerns over the FCA proposed regulations during the public comment period. The over-riding theme of the comments is the failure of the FCA proposed regulations to do little more than provide another restatement of the legislation. The proposed regulations fail to address the serious problems farmers have been facing with FCS since the January 6th enactment of this legislation.

Today, my remarks will address the flaws I see in FCS's implementation of the Act. I believe the most urgent problem is the one of inconsistency. Not only is there a difference of interpretation and treatment of borrowers between the districts but also from state to state within the same district. The Act is a Federal law and we feel this calls for consistency system-wide.

ACCESS TO INFORMATION

We believe the biggest problem borrowers are facing today in trying to restructure their debt is the lack of information. Policy statements are simply a restatement of the law. There is no explanation of significant terms such as monetary concessions or Present Value of Principal Foregone. There are no formulas and guidelines that outline procedures to follow in developing a plan for restructuring.

Most important we need the calculations that FCS is using to determine if a loan is suitable for restructuring and the

conditions of restructuring. This needs to be done on an individual basis and the borrower should be completely informed and aware of the calculations and judgemental assumptions used in the determination. Whether a plan is accepted or rejected the borrower should know the reasons. We also feel the borrower should be offered a counter plan when the borrower's preliminary plan is rejected. This is consistent with good business negotiations in other segments of society. This would also seem to be consistent with the provisions of the Act which call for restructuring when it is less costly than foreclosure. It would seem that the loan officers are simply passing judgment on the preliminary plan and sending it on to the credit review committee without explanation or their analysis. There appears to be an attitude of simply going through the motions of complying with the law without really doing so!

The loan officers seem to be masters at using the bureaucracy to avoid making any concrete decisions. They say they have received their orders from higher authorities and cannot stray from them. It is also hard to find out who has the authority to make a decision.

It has been particularly distressful for me to note that a borrower will not be given his rights or due process when he meets alone with the loan officer. However, when a farm advocate who knows the provisions of the new Act accompanies the borrower, the loan officer suddenly becomes very cooperative. They make a point to repeatedly say that they will do everything they can to make this situation work and keep this farmer on the land. That sounds very good but until we know exactly how they are making decisions and who ultimately is making them, we are not convinced that they are doing more than going through the motions.

We are beginning to see FCS providing people with their appraisals with less hassle than in the past. However, we would like to ensure that appraisals are conducted by truly independent appraisers. An appraisal done by an FCS employee or recent employee is not an independent appraiser. We feel appraisers should have had no association with FCS for at least two years. This is consistent with similar restrictions on government workers and civil service jobs or military personnel and private industry connections.

PUBLIC AUCTIONS

Public auctions have been used to circumvent the rights of previous owners. In many states, public auctions were never used prior to passage of the Act. Further evidence of these actions to circumvent the law is that they are always used when an owner is trying to regain control of even a portion of his land. The loan officer is making the determination of who farms and who does not based on emotional, subjective judgments and not sound business decisions. Farmers who have become delinquent are

too often pegged as "deadbeats" not deserving of another chance in the eyes of the loan officer.

MEDIATION

In light of the track record of the lack of good faith negotiations on the part of FCS loan officers, FCS should be mandated to participate in state mediation programs regardless of whether they are mandatory or voluntary programs. In many cases this is the first place the farmer will be allowed the information needed to prepare a restructuring plan. In addition, the clocks on foreclosure should stop ticking during preparation for and mediation.

INVOLUNTARY PAYMENTS AND BILLING STATEMENTS

The proposed regulations would allow FCS to take funds held and/or allocated for one purpose and apply them to something else, solely at the discretion of FCS. The regulations would not require any notice to the borrower. We feel this should not be allowed in any form. This is interfering with management decisions and taking the decision making authority away from the farmer. In the past this kind of activity and interference has resulted in many successful lender liability suits against commercial lenders.

Some farmers are not getting billing statements at all. Some farmers are getting a monthly accounting of their accounts. In some cases, there are miscellaneous charges on their bills with not explanation or documentation. No one seems to know who to contact to get an explanation of these mysterious charges.

USE OF GUARANTEED LOANS

We feel Congress was very clear that FCS was to use the FMHA loan guarantee as much as possible in repurchase of land and restructuring of loans. However, there seem to be situations occurring where FCS is writing down the debt yet setting aside a portion to be dealt with at some future unspecified time and manner. FmHA is choosing to disallow the use of guarantees in these instances. We feel this is poor business practice on the part of FCS. They are choosing to forego the guarantee of the appraised market value of the loans' collateral on the chance they will regain all or part of the amount written off. We feel this is ensuring failure for the farmer and ultimately for FCS.

CONCLUSION

I appreciate the opportunity to have presented our concerns to you this morning. Farmers are counting on Congress to take an active role to ensure that we are able to fully benefit from the credit reforms in the new Act as Congress intended. We urge Congress to put pressure on the Farm Credit Administration to ensure that they act as both a regulator and a protector of the

System by ensuring that the law is followed by all FCS Districts and lenders benefitting all FCS borrowers.

Even before the drought, many farmers last hopes for survival were based on the credit relief in the Agricultural Credit Act of 1987. We urge you to act quickly to ensure that the dual goal of helping save family farms and scarce federal resources are met with the proper implementation of this most important legislation. Thank you.

A letter from Benny Bunting, president, National Save the Family Farm Coalition to Anne E. Dewey, General Counsel, Farm Credit Administration dated June 11, 1988, follows:

National Save the Family Farm Coalition

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June 11, 1988

Anne E. Dewey, General Counsel,
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090.

Dear Ms. Dewey:

I appreciate this opportunity to comment on the FCA proposed regulations for the Agricultural Credit Act of 1987 published in the May 12th Federal Register. These comments are presented on behalf of the 46 member organizations of the National Save the Family Farm Coalition.

We have been very concerned about the implementation of the Agricultural Credit Act of 1987 since its enactment on January 6, 1988. These proposed regulations fail to clarify the inconsistent and confusing policies of FCS districts during the past five months. We urge the Farm Credit Administration to issue final regulations that provide borrowers with specific information to utilize their new rights in the Agricultural Credit Act of 1987.

The first section of our comments focus on those areas where the proposed regulation comment section asked for specific input into the final regulations.

SECTION 615.4518: NOTICE OF DENIAL OF RESTRUCTURING AND RIGHT TO REVIEW

The denial letter should be sent certified mail to the borrower to verify the date of receipt. We believe the calculations, assumptions and reasons for denial should be included in the letter. This saves the borrower time in determining their next step and reduces FCS expenses by not having to respond to requests for this information. This information is not only valuable in determining whether to appeal, but also in making counter offers that the borrower can live with and would also be acceptable to the lender. The lender has asked the borrower to act in good faith by putting all of his information on the table. It is not unreasonable to ask the lender to do the same.

FCS institutions should make every effort to aid the farmer in exercising appeal rights. At the very least, the 7 day deadline should be in bold print in a very obvious place on the letter. There should be a separate form to send back to request the appeal. The 7 days should be counted from the date of receipt of the letter. An additional 7 days should be allowed when the

notice is sent to a third party only, such as an attorney, accountant or other representative.

The list provided to the borrower of the calculations used to determine the least cost alternative should include, but not be limited to the following:

- -- Interest rates
- -- Length of payback
- -- Principal amount financed
- -- Amount,if any,deferred
- -- Interest on deferred amount
- -- Price/Cost of Production ratio for any and all commodities that trigger the deferral. This is the cash flow that triggers the deferral. If they are using an appreciated mortgage, then it is the amount of appreciation that triggers the set aside.
- -- Attorney's fees and other administrative fees
- -- Holding costs for land held in inventory

The following additional factors should be shown as well:

- -- Figures used for family living
- -- Machinery cost and replacement
- -- Building upkeep, repairs, and maintenance
- -- Government payments
- -- Off farm income
- -- Taxes and insurance to be paid
- -- Taxes to be paid on principal forgiven
- -- Amount of debt service on other debts

These figures should be used in the FCS cash flow determination. They should document them just as the farmer must be able to document his cash flow projection.

This information is valuable to both a farmer denied restructuring as well as to a farmer whose restructuring plan was accepted. This is not additional work for the loan officer. These are computations and formulas that should be worked out in determining whether a loan is distressed and whether it is more costly to foreclose or to restructure.

There should be clear explanations for all bills sent to borrowers by FCS. Borrowers have a right to a fully itemized and detailed explanation of any charges from FCS.

SECTION 614.4519 (c): NOTICE BEFORE FORECLOSURE: LIMITATION ON FORECLOSURE

We believe the law is very clear that all borrowers were intended to have the right to attempt restructuring and to remain on their farms if it is the least cost alternative. Many farmer/borrowers have been denied their rights under the Agricultural Credit Act of 1987 including the opportunity to apply for debt

restructuring, access to documents, and right of first refusal.

We recommend that no foreclosure notice be issued until all attempts to examine restructuring possibilities have been exhausted. This includes the time when the borrower is demonstrating an attempt to develop a plan or correct the factors that have caused the loan to become distressed.

The timing of the foreclosure notice is very important. An unnecessary and untimely foreclosure notice can cause additional stress and pressure on a borrower resulting in irreparable damage to a borrower's operation and ability to restructure. Although the proceedings can be stopped when directed by the special asset grup, the damage may in many cases already been done. This hurts both borrowers and the FCS District bank.

After all attempts have been exhausted and/or the borrower has not responded to the 45 day letter, then we recommend a notice of loan acceleration with 30 days to pay the loan in full be issued. After this timeframe has expired, then a foreclosure notice could be issued.

SECTION 618:8310(B)(1) STOCKHOLDER LISTS

The requirement that FCS provide stockholder lists within 7 days of the borrower's request is fair. However the proposed regulation does not clarify to whom in the System the request should be made and just what the procedure is. In some districts no one either accepts the responsibility for releasing the list or knows of anyone with this authority.

SECTION 618.8325 ACCESS TO DOCUMENTS AND INFORMATION

We agree with the FCA proposed regulation stating that FCS District bank policies should allow each borrower one copy of all documents free of charge. This provision should be clearly stated in the policy statement of each FCS district bank. We urge FCA to clarify whether all signors on a loan will receive a copy of the documents or only one per loan.

FCA should develop a consistent System-wide policy on what information should be released to the borrower. We feel that any information that is considered in the decision to make any changes in status of a borrower's loan should be made available to that borrower. If it is too privileged and too confidential to be shared with the borrower in question, it is too privileged and confidential to be taken into consideration when making determinations that will impact the loan being evaluated. This decision to release information should be a System-wide mandate and not left to the discretion of a loan officer.

SECTION 614.4367(B)(2) WAIVER OF RIGHTS

If a loan is being pooled, the borrower will be asked at closing

to sign a waiver of rights to restructuring. Prior to signing a waiver, FCS should provide a written statement of the rights associated with restructuring that would be afforded to the borrower in the event the loan is not pooled. The borrower needs this information to make a sound business decision on the choice to have the loan pooled. A model form for the waiver should be issued for public comment. The final form should be used by all FCS districts for consistency in the waiver provision.

We question what the borrowers recourse is in the event these written notifications are not properly and promptly provided.

SECTION 614.4367(C)(3) FACTORS TAKEN INTO ACCOUNT IN NEW INTEREST RATE

All factors should be listed, standard or otherwise. This notice should be provided at least 30 days in advance to enable borrowers to consider possible options to switch lenders.

FCA should require FCS institutions to publicize the loan review process so that borrowers have the opportunity to have their current interest rate reviewed to see if they are eligible for a new, lower rate. This change could help keep the loan from becoming distressed in the future.

SECTION 614.4367 (d) and (e) REQUIRED DISCLOSURES:

Any actions to change amount of stock or participation certificates required by borrowers should be provided in writing 30 days, not 10 days before such action can take effect. In loans with more than one obliger, the proposed regulations for this entire section should clearly state that all disclosures should be received by all parties affected.

MODEL DISCLOSURE FORMS:

We question why the model forms submitted for public comment are for optional use by FCS Districts. What is the purpose of public comment on the forms if they are not required for use by all FCS Districts? FCS Districts should have to use a standard form to ensure that borrowers are receiving consistent information. FCA should take a strong position on standard forms and letters to minimize confusion. Failing to require the use of a standard form will ensure continuing discrepancies between districts with similar results as the 45 day restructuring letters where borrowers in different districts received very different letters that were in many cases wrong and misleading.

SECTION 614.4440 DEFINITIONS

FCA regulations should state that a glossary of terms used in normal operations and loan restructuring should be developed for use System-wide. This glossary should be made available to every stockholder.

The policy statement of the qualified lender system-wide should state very clearly that a restructuring request must be in writing. Loan officers should be directed to give the borrower a copy of the policy statement in writing. Casual visits with loan officers and comments that "one is not eligible and should not bother to apply" are often taken by farmers as firm denials. The loan officer cannot and should not be making any comments on the individual borrowers eligibility until all written supporting documents have been received.

SECTION 614.4440(C)(3) APPLICATION FOR RESTRUCTURING

FCA regulations should clearly state what type of information is required as part of the application and to clearly define a "preliminary restructuring plan". The borrower should be furnished with a list of all the financial information and repayment projections required by the lender. Too many times applications have been denied for lack of data or borrowers have been accused of not acting in good faith when the required information is a new provision. An example is the change from 3 years of prior tax returns to 5 years.

SECTION 614.4440(D)(1) DISTRESSED LOANS

It is not clear whether the determination of a distressed loan based on a borrower demonstrating adverse financial and repayment trends is based solely on the FCS loan or on other accounts held by the borrower. FCA regulations should clearly state the policy and instruct FCS to include this provision in System-wide policies.

The clause, "as determined by the lender" should be deleted since it narrows the definition in the Ag Credit Act. This change means that the borrower cannot initiate the contact if they are aware that they will unable to meet upcoming payments. Resolving potential adverse payments at the earliest possible time is in everyones' best interest.

SECTION 614.4440(G) RESTRUCTURING

The borrower should be clearly informed as to what criteria have to be met and what actions must take place to meet FCS' definition of a financially "viable" operation. The loan officer and the borrower should be talking the same language in order to make this determination since it is critical to the restructuring proposal.

SECTION 614.4441 (A) NOTICE OF ACTION ON LOAN APPLICATION

The tangible reasons for the decision of a qualified lender should be provided to all parties involved on the loan under consideration. These tangible reasons should include all

computations and assumptions used to make the decision on the loan.

SECTION 614.4442 CREDIT REVIEW COMMITTEE

We agree with the proposed regulation calling for no participation on the Credit Review Committee by the loan officer involved in the case. The farmer/borrower seeking a review by a credit review committee should have the option with due cause to refuse at least one member of a Credit Review Committee if the farmer can show that in some past association the member of the Committee may have reason to be subjecive in considering this farmer's case.

The farmer should be informed in writing of both the right to appear in person before the Credit Review Committee and what documentation will be considered. The proposed regulations are not clear. It should also be made clear to the borrower that this meeting should not be a time for additional plans or further negotiations.

The FCA regulations should clearly outline the function of the Credit Review Committee, both eligibility for serving on the Committee, and the importance of the Credit Review Committee maintaining an independent and fair appeals process. The regulations should define the role of the loan officer in the Credit Review meeting and clearly state that the meetings should be in a neutral location, not in the FCS office.

SECTION 614.4443: CREDIT REVIEW PROCESS

(c) Independent Appraisal: An independent appraisal should be allowed at the first point of disagreement over the appraisal between the loan officer and the borrower. The borrower should be allowed to use any independent accredited appraiser approved by the qualified lender. These listed independent accredited appraisers should not have been employed by FCS or FmHA or accepted fees from FCS or FmHA for work done or on a retainer for the last two years prior to doing an independent appraisal.

SECTION 614.4512: DEFINITIONS

(c) Cost of Foreclosure: This definition provides nothing more that a restatement of the legislation. Terms and conditions should be specified. In the preamble of the proposed regulation it states, "a regulation cannot exhaustively list what all costs are." It doesn't have to list all costs but it can list the major costs as a guideline to help farmers develop their plan. The actual costs will vary on a case by case basis and should be evaluated individually not by a formula.

The estimated cost of attorneys' fees should be based on a realistic cost to the lender of these charges, possibly along the lines of Chapter 12 attorneys' fees, not based on whether the

attorney is on retainer for general work with the FCS District.

(h) Monetary Concessions: This term in the definition of restructuring must be clearly defined in the regulations and included in the policy statement of the qualified lender.

SECTION 614.4513 (B) INVOLUNTARY PAYMENT ACCOUNTS

The policy and practice outlined in this proposed regulation should not be allowed. This action with or without notice is a violation of the borrowers right to make decisions to carry out the management of his own operation. By allowing this kind of loan payment activity the lender is making decisions that interfere with the borrower's operation of his farming business.

It is just this kind of loan activity that has led to many successful lender liability suits against commercial lenders. This kin of adverse litigation should be avoided at all cost by the FCS.

SECTION 614.4516: RESTRUCTURING PROCEDURES

(a)(2) - Notice: "All materials necessary" needs to be defined as including but not limited to all calculations used to determine a loan is distressed. The notification must be sent to all parties affected by the loan and not to just one of the signors. This is meant to include all borrowers and attorneys for the borrowers.

(b) - Opportunity for Meeting: The borrower should be clearly informed of an opportunity to meet personally with the lender. A written waiver of the personal meeting should be the only reason for no meeting. The borrower should have the option of meeting with a different loan officer or representative of the lender in cases of personality conflict or communication breakdown.

(2) The regulations should require FCS to make a counter-proposal to a borrower who submits an initial plan of restructuring that is not acceptable. Good faith negotiations include both sides participating in the process. If the farmer has figures and assumptions that are unacceptable, then it is the duty of the loan officer to clearly state the reasons for the denial. Farmers have been receiving rejection notices with little explanation of why their preliminary plans were in fact rejected. The only option being presented is an appeals process, not an opportunity to submit alternative proposals or negotiate a compromise.

SECTION 614.4517: RESTRUCTURING DECISIONS

This entire section contains terms that must be clearly defined.

(a): <u>Consideration of Application</u>

(2) What standard is being used to determine "necessary and reasonable living and operating" expenses? This is a very subjective criteria in the debt restructuring application.

(3) What does "financial capacity and management skills to protect the collateral from diversion, dissipation, or deterioration" mean ? Who evaluates these skills? A farmers' current financial situation should not be taken into consideration. These terms are very subjective determinations. If they do form the basis for an adverse decision, at the very least, they should be part of the borrowers' file and available for review.

(4) The term "viable" needs to be defined.

(5) In this paragraph the use of "sound lending practices" seems to mean something different than the least cost alternative in the decision between restructuring and foreclosure. This needs to be clarified as to how and why this situation will be treated differently than any other restructuring procedure. The borrower and the lender should be allowed to develop a written agreement enabling the borrower to make a payment late if sound farming or marketing practices dictate without going against "sound lending" practices.

(C)(1) EVALUATION OF COST OF RESTRUCTURING

The formula and calculations used in determining the cost of restructuring must be given to the borrower not just considered by the lender.

(1) What does present value of interest and principal foregone by the lender mean? This is a term that is not easily calculated by borrowers or accountants and must be clearly explained.

(2) There should be a definition of reasonable and necessary costs with a list provided.

(3) The legislation, regulations, and the district policies all discuss "preliminary plans" yet borrowers are being told that these plans once submitted cannot be changed. These initial plans should be subject to change based on different factors including farm plans, projected income, appraisals, and weather conditions.

SECTION 614.4518-NOTICE OF DENIAL OF RESTRUCTURING AND RIGHT TO REVIEW AND SECTION 614.4519-LIMITATION ON FORECLOSURE ARE IN FIRST SECTION OF COMMENTS.

SECTION 614.4522 RIGHT OF FIRST REFUSAL

(a)(2)(b) The determination upon acquiring property as to whether the previous owner "had the financial resources to avoid foreclosure" should not affect the farmer/borrowers' right of

first refusal. This paragraph should be eliminated. The decisions of the past and the conditions that led to that decision should not be held against a previous owner. All previous owners should be given the right of first refusal, as Congress intended, and their purchase and/or lease options should be judged on present conditions and evaluations.

The 15 days for farmers to respond to notification should be 30 days since the 15 days was a typographical error in the legislation that has been corrected in the pending technical amendments. Previous owners should be allowed adequate time to seek financing much as is allowed in any other real estate purchase agreement. The timeframe should be based on business days not calendar days.

FCS should consider financing the acquired property if the same conditions and terms can be met by the previous owner as would be required by a new owner/borrower.

All decisions to reject right of first refusal should be appealable as well as all determinations used to deny right of first refusal offer to purchase and/or lease with option should be provided to the previous owner in writing and appealable.

SECTION 614.4522 (E) PUBLIC AUCTION

The proposed regulation should be clarified to clearly state the previous owners' right to purchase the property at appraised market value before a public auction. Deleting the phrase, "except as provided in paragraph (e) from the beginning of Section 614.4522(c) and 614.4522(d)" would ensure that the regulations are not going against congressional intent in the use of public auctions to avoid the right of first refusal provisions of the law. Recent court decisions have found ongoing FCS actions illegal.

Property should have to be in inventory a minimum amount of time after it has been offered to the previous owner before it can be sold or leased to anyone other than the previous owner except when the owner has waived all rights of first refusal in writing.

This waiver should only be accepted after it has been documented by the loan officer that the previous owner has been fully informed of the right of first refusal. This is necessary to prohibit loan officers from making personal judgements regarding the previous owners right to start over or to regain access to a piece of property.

HOMESTEAD PROTECTION:

The proposed regulation needs to be modified to clearly implement the Statement of Managers understanding that Right of First Refusal includes provisions granting "homestead-type" protection to FCS borrowers' whose land is in inventory. This could be done

by including "or any portion of the property" to the right of first refusal section. A new section in the proposed regulations would be necessary to cover appraisals.

SECTION 615.5255 RETIREMENT OF CAPITAL STOCK

A borrower should be allowed to retire stock against the outstanding principal whether or not the principal was reduced. This has not been addressed in the regulations. This would allow the borrower to reduce his debt and leave less stock for the system to guarantee.

SECTION 614.4521(a): PARTICIPATION IN STATE AGRICULTURAL MEDIATION PROGRAMS

This section states that "if initiated by a borrower, system institutions shall,...participate in State mediation programs certified under section 503(b) of the Agricultural Credit Act of 1987". The proposed regulation should state that in those states which require mandatory mediation, FCS shall initiate the mediation process.

The proposed regulations refer to programs certified by section 503(b) of the federal statute. The regulations should expand upon the requirements for certification outlined in the statute; in particular, the "adequate notification" requirement of section 501.(c)(5)). The term "adequate notification" should be clarified. Most farmers, and many local agricultural lenders, are not familiar with the mediation process. Farm lenders should take the responsibility of informing borrowers that the service exists. "Adequate notification" will play a very important role in the success of the mediation process. The regulations could strengthen this requirement in the following ways:

* Certified state programs should send brochures to all farm borrowers and lenders advertising the mediation program.

* Certified state programs should put out periodic Public Service Announcements and press releases advertising the mediation program.

* The name, address, and phone number of the mediation service should be printed on all foreclosure notices or notices of intent to take adverse action.

Farmers who have requested mediation should be allowed to participate before they exhaust their administrative remedies. The proposed regulations provide that system institutions shall participate in mediation either concurrently with loan restructuring or at any other appropriate time. Mediation is not appropriate after a final decision. It should take place during the preliminary restructuring phase or if during the 45 day time period there should be an automatic extension to accomodate the mediation process.

I appreciate the opportunity to have presented these concerns on behalf of the National Save the Family Farm Coalition. I hope that my suggestions as well as comments that you have received from other farmer/borrowers around the country will be taken into strong consideration when finalizing these regulations. It is the actions that the Farm Credit Administration takes through its regulations that will determine whether there will be consistency between Farm Credit System Districts and opportunities for all of its farmer/borrowers under the Agricultural Credit Act of 1987.

Sincerely,

Benny Bunting

Benny Bunting
President

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United States Senate

COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

July 12, 1988

Ms. Susan Bright
Save the Family Farm Coalition
1864 West Grove Road
Centerville, Indiana 47330

Dear Ms. Bright:

We appreciate your testifying before the Committee on June 16, 1988. Enclosed are additional questions which are being submitted to you for written answers. We would appreciate receiving your answers to the questions by July 29, 1988 so that the hearing record may be printed as soon as possible.

Thank you for your cooperation.

Sincerely,

DAVID L. BOREN
Chairman
Subcommittee on
Agricultural Credit

Questions from Senator Tom Daschle
Hearing on the Implementation of the Agricultural Credit Act of 1987
Senate Agriculture Committee
June 16, 1988

Susan Bright, Save the Family Farm Coalition

I have been contacted by many constituents who find it awfully difficult to fill out the restructuring forms, because they are not clear what is actually needed by the System. Are you aware of this problem and can you let me know what you see as the implications of these vague forms?

National Save the Family Farm Coalition

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BOX 414
CIRCLE, MONTANA 59215
(406) 485-3324

August 4, 1988

Senator David Boren, Chairman
United States Senate
Subcommittee on
Agriculture Credit
453 Russell Office Building
Washington, D.C. 20510

Dear Senator Boren:

We appreciate the opportunity to answer the following question from the committee members on the implementation of the Farm Credit Act of 1987.

At this time I would like to respond to the question asked by Senator Tom Daschle:

> "I have been contacted by many constituents who find it awfully difficult to fill out the restructuring forms, because they are not clear what is actually needed by the System. Are you aware of this problem and can you let me know what you see as the implications of these vague forms?"

The size of the packet of information that is sent to farmers is sometimes intimidating. Most farmers feel the loan officer already knows all there is to know about the farmer's situation and therefore this is looked at as a form of cruel and inhuman treatment. There are no guidelines included in the restructuring applications. It is like playing basketball and not being able to see the goal. One farmer who has been trying to restructure for several months felt that if you get a restructuring packet FCS has already decided to liquidate you. This whole process in his opinion is just a formality.

The restructuring packet is not the only problem with the current process. Provided a farmer decides to attempt restructuring in spite of the complex forms, getting information from the loan officer is next to impossible. The loan officer seems to be authorized to tell you what he will <u>not</u> do, but not authorized to tell you what he <u>will</u> do. One farmer felt that if FCS was serious about restructuring, they would at least offer counter-proposals that were sincere. Not a counter-proposal that was an outline form for a liquidation process.

Many other farmers are of the opinion that if FCS was sincere about restructuring they would offer a plan or proposal up front. In Chapter 12 reorganizations the legal counsel for FCS is very eager to submit the reorganization plan for the farmer. They almost never accept the farmer's plan, but have lots of alternate suggestions and additions for the plan.

Another problem with the restructuring forms and required information is the emphisis on past history. This so-called chance to have a future is being unduly hampered by relying on past performance and history. This is supposed to be a fresh start. Five years of tax returns do not reflect an accurate picture of a farm operation or future potential. This is looked at by the farmers as a way to find a reason to say no to a proposal rather than a sincere attempt to help.

The idea of FCS not being sincere in its attempts to restructure is reinforced by the fact that so much material and information is requested of the farmer and yet very little information is supplied to the farmer by FCS. In a classic catch-22 situation, the farmer can go nowhere without the required information from the FCS, and the FCS will not provide that information to the farmer. Add to this the fact that the decision not to restructure is based on poor credit history and poor feasibility, based on poor past performance, it is very difficult to believe FCS has honorable intentions.

We believe the vague forms and lack of action on the part of FCS is deplorable. We believe they want to put as many people off the farms as possible, while looking like they are complying with the law. Farm families cannot survive financially or emotionally for an extended amount of time in such a state of uncertainty.

We hope these actions, or lack of action, by FCS and FCA will demonstrate to Congress the need for more oversight and stronger language to define the intent of Congress under the Agricultural Credit Act of 1987. Current drought conditions makes the effective implementation of the Agricultural Credit Act of 1987 imperative.

Thank you again for the opportunity to bring our concerns to the attention of the subcommittee. We thank you also for all of your hard work on behalf of family farmers across the nation.

Sincerely,

Susan Bright

Susan Bright

Senator BOREN. I appreciate your comments and let me assure you that I think a big part of this is to nail down these calculations and to get that into the regulations in the appropriate way, and we are going to make every effort to do that.

I appreciate your comments. You know, somewhere along the line, I do not know where it happened, but I can remember going to local association meetings with my dad when I was a kid, and the farmers really were in control of that system and everybody felt it was theirs, and somewhere along the line we lost that to some degree. I do not know exactly where that happened, but it began to no longer be the farmer-owned, farmer-directed System in which the farmers were setting the policy.

Ms. BRIGHT. Our efforts have been targeted to organize farmers to do just that, you know, the regulations propose that we are allowed the stockholders list, but it is real interesting that nobody knows who has got the authority to give it to you.

Senator BOREN. Well, that is an interesting point.

Ms. BRIGHT. I thought so. I have a letter ready to go, but I do not know who to send it to.

Senator BOREN. I understand. I think that is part of it. I will look into that, too, but we need to get people reactivated and get them involved in taking back control of the System. We have had that happen. We have had some contested elections in our district and so on and farmers wanted to see a change of policy. I have seen that happen to some degree in our district, as changes of policy occurred.

Mr. Massey, we are happy to have you with us today.

STATEMENT OF JAMES T. MASSEY, EXECUTIVE DIRECTOR, FARMERS' LEGAL ACTION GROUP, INC., ST. PAUL, MN

Mr. MASSEY. Thank you, Mr. Chairman. I appreciate the chairman's invitation to testify today.

Very briefly by way of background, I am testifying today specifically on behalf of clients I represent in two class action lawsuits, and, more generally, on the basis of background information from hundreds of phone calls that we get in my office and literally hundreds of farmers and ranchers we meet with around the country, including in the State of Oklahoma with Dr. Glenn and his organization.

My organization is in the business of providing legal education to farmers through publications, lectures, workshops and so on, in addition to conducting litigation. We also assisted the Family Farm Coalition in drafting some of the proposed pieces of this legislation.

I am also lead counsel in the *Coleman* v. *Lyng* litigation in North Dakota against the Farmers Home Administration. Many of our clients in that case are also Farm Credit System borrowers.

It is not amusing, but I was a bit amused by thinking today, while they are stealing rugs in Jackson, they are stealing my clients' farms up in Spokane and St. Paul. I do not mean in a criminal sense, but when property is taken in violation of the law, it is a form of theft. We now have several Federal court judges who have agreed with the analysis that we have made several interpretations

and applications of the act that are currently the subject of litigation.

The concern is more than with individual acts; there are two levels of concern. One, we are talking about systemic problems, not individual problems. I will give you three examples. Two, the overarching concern here is what I saw evidence of again here today. The Farm Credit Administration appears to be taking a real sideline position, particularly with respect to enforcement, any kind of enforcement, of the borrowers' rights——

Senator BOREN. They have to become aggressive about that.

Mr. MASSEY [continuing]. Borrower's rights provisions.

Senator BOREN. They must become aggressive about enforcement.

Mr. MASSEY. They are going to spend their time, frankly, as defendants in these lawsuits, when they could spend the same amount of time being proactive, using the very considerable—and I disagree with the characterization of how long it takes for them to use their enforcement powers—the very rapid enforcement power they have under the 1985 Ag Credit Amendments, which gave them pages of cease and desist powers with which they can move very quickly. In fact they can freeze the administrative authority of any officials in the System if it is determined that they are doing something that threatens the financial security of the System or are violating the law. They have absolute authority to use that cease and desist power to enforce the law.

Senator BOREN. I agree with your point.

Mr. MASSEY. There are three systemic interpretation problems. Clearly Mr. Beesley and his group have not been persuasive in the St. Paul District, particularly in the Spokane District and in the Wichita District on these provisions.

I heard Mr. Naylor testify here and before the House Committee about 2 months ago that he and his colleagues understood the act to extend the right of the restructuring notice and opportunity to apply to all borrowers, even those who were in the foreclosure pipeline on January 6, 1988. I read the act that way and my staff does, my clients do, Mr. Beesley's group does, but the Spokane District does not.

We filed a lawsuit called *Harper* v. *Federal Land Bank of Spokane,* in Portland, about 2 months ago. Judge Panner, the Chief Judge there, also agrees, at least tentatively as to a preliminary injunction, that this is the correct interpretation. Spokane has had the opportunity to amend its ways. Mr. Naylor has had the opportunity to exercise his power. He is a defendant in that lawsuit, so he understands what it is about, and so far the response we have gotten is that they are not only disregarding that interpretation, but they are going forward in other cases.

I just filed another part of that case there on behalf of Robert and Carol Garnett of Imnaha, Oregon, which is my native State, who are in the identical position as the Harpers, in the pipeline on January 6. They were not offered restructuring. We had a temporary restraining order hearing last Friday over the telephone and Judge Panner issued a second restraining order against the Spokane District, ordering them not to evict my clients, which was threatened through a writ of assistance by the sheriff last Friday.

We have on Monday a show cause hearing in the *Garnett* case, and on Tuesday a trial in the *Harper* case, all on the same issue, all on the issue that I have heard Mr. Naylor, Mr. Beesley, members of this subcmmittee, members of the House Committee and everyone apparently other than several CEO's of the districts—particularly in this case, Spokane—agree that the act says one thing and they are doing another thing.

This to me is like the conversation I had with the CEO of the St. Paul District shortly after the 1985 act was passed. I believe the chairman would remember section 307, the least known and never enforced provision on restructuring of the Agricultural Credit Amendments Act of 1985. I asked Mr. Buegler there, I said what do you intend to do about section 307, how do you intend to implement it here? Mr. Buegler picked the Federal statute up like it was something he did not want to look at and he said, "I do not know what it says in here, but whatever it is, we are going to do something different and better."

That strikes me as being like what the chairman heard today initially from Mr. Thor and from Mr. Naylor. I am a trial attorney by nature, but I have gotten into the law enforcement business by necessity. I am troubled and outraged at times on behalf of my clients, and as a taxpayer, that these people appear to have given unto themselves what I read the Constitution as giving to this body, and that is the ability to write legislation.

Their job is to interpret it in some cases and certainly to enforce it. I am troubled because we are using at this point very few dollars and, frankly, the people who are out there enforcing the act other than in the Jackson closure, appear to be Willy Nelson, who funds my operation, the Minnesota State Legislature which also funds part of my operation, and a couple of private attorneys who have managed to put lawsuits together around the country. I do not think that makes much sense.

I think the Farm Credit Administration should be doing it.

There are two other specific issues, the right of first refusal, the Jackson District, the St. Paul District, the St. Louis District and perhaps others, but those I know for sure, have basically attempted to rewrite the law by writing out subsection (b) of section 106, which says 15 days after the institution first elects to sell, it shall provide the borrower the notice of the right to buy the property at appraised fair market. Wichita has this interpretation as well, I understand.

The districts have decided that they do not have to do that if they do not want to, if they elect to sell under subsection (d) through a public sale.

Senator BOREN. Yes.

Mr. MASSEY. I think it is nonsense. Judge Webb, up in North Dakota, characterized that interpretation as "bizarre and unusual," Judge Deavitt, a senior Judge in the District in Minnesota, in an other case, called *Leckband* v. *Naylor,* said it was preposterous and said that it made no sense at all.

Senator BOREN. No, the law is clear, you cannot get around that requirement by saying you are going to public sale.

Mr. MASSEY. At the same time they are litigating that case—the Justice Department is litigating it on behalf of Mr. Naylor—the St.

Paul District is litigating it with a very expensive law firm on behalf of itself, and we wind up in the Eighth Circuit in both the *Martinson* case, which was Judge Webb's decision in North Dakota, and the *Leckband* case in St. Paul.

I think it is important at the same time that in Omaha, of course, they have not followed this interpretation, but again in Jackson they unloaded a huge amount of property without providing the initial subsection (b) rights; in Illinois, the same thing occurred, and again in St. Paul that is what they want to do.

The other issue in these cases is whether or not the act applies to property in inventory on January 6. Farm Credit interprets the language "is acquired" to be a future tense verb. Judge Webb said no, it is an adjective, it is "temporally neutral." It does not matter when it was acquired; if you have got it you have to apply the right. Again the district is appealing that order or will be appealing and resisting that order as to that property.

So in those three ways, in the sense that we are talking about theft as an illegal act, an illegal taking, not as a criminal act, our clients' farms are being stolen. I have not talked to them today, but I think they would just as soon give them the rugs in Jackson, let them take the rugs but let us keep the farms.

I am not here to complain about reasonable differences in interpretation of the law. That is what courts and lawyers are for. What I am here to say is I think we are allowing a misuse of resources. No one is minding the store. Mr. Naylor is not attending to the business that he and his colleagues are mandated to under the act. The statute says they are to promulgate necessary regulations, and I think it is necessary, when the question is threshold compliance with very clear provisions of the law. This is not witchcraft, it is not very creative stuff. We read the law, we file the lawsuit and the courts so far unanimously support the farmers' position on these things.

So I would ask—I do not know what this subcommittee or the Senate can do more. The law is a good one. We worked on it some. I know how hard this subcommittee worked on it and the staff worked on it. I think in both the Farmers Home case—and we will have a chance to visit next month on the Farmers Home provisions—and in the Farm Credit case, we have seen an arrogantly entrenched resistance at some levels to the enactment of this law. Through this oversight process, through the admonition of the chairman and the members of the subcommittee, perhaps we can see more compliance.

I appreciate the subcommittee receiving our full testimony and our comments. Let me just close by noting—and this is a fairly arcane point and I think we are not quite ready to look at it as closely as we all should, concerns about the restructuring formula. I think the statistics cited by Senator Conrad, 10 percent or perhaps less, of people getting successful restructuring plans has to do with how the System is interpreting the cost of foregone principle and interest.

If the Congress really meant the FCS to calculate all foregone paper principle and interest, it is a self-defeating formula. The only way that formula can make sense is to look at what the lender really could expect to collect from the loan, not what they would

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like to collect, if that loan were fully secure and the farmer had full repayment ability.

The formula that we have seen in the St. Paul District and the Spokane District and the Omaha District I think is designed for failure. I think it is commercially unreasonable. I do not think it carries out the intent of the Congress, and that is why we are going to see the abysmal numbers on successful restructurings.

We have engaged a consultant, an agricultural economist, a professor, who is going to help us prepare an analysis of that, and we will certainly forward it to the subcommittee when we receive it.

Thank you very much, Mr. Chairman.

[The prepared statement, attachments, letter, questions from Senator Daschle, and responses of Mr. Massey follow:]

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TESTIMONY OF JAMES T. MASSEY
ON BEHALF OF FARMERS' LEGAL ACTION GROUP, INC.
BEFORE THE UNITED STATES SENATE
SUBCOMMITTEE ON AGRICULTURAL CREDIT OF THE
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
JUNE 16, 1988

My name is James T. Massey. I am the Executive Director of Farmers' Legal Action Group in St. Paul, Minnesota. Farmers' Legal Action Group is a nonprofit organization that provides legal education, training, support, and assistance to farmers and attorneys throughout the country. We are currently co-counsel in Leckband, et al. v. Naylor and Harper, et al. v. Federal Land Bank of Spokane, both class action lawsuits brought to enforce provisions of the Agricultural Credit Act of 1987. I am testifying today at the invitation of Senator Boren.

It has now been approximately six months since the enactment of the Agricultural Credit Act of 1987. Unfortunately, this time period has been marked with problems involving the proper interpretation and implementation of the new Act by Farm Credit System.

These problems involve the following areas: restrictive interpretation; inconsistent application; failure to disclose information; and the failure of the FCA to fulfill its obligation to assure the proper implementation of the Act. These areas are discussed as follows:

Restrictive Interpretation

In many situations, FCS districts are taking positions which greatly restrict the application of the borrower's rights provisions of the new Act. This is perhaps best emphasized by the failure of the districts to provide restructuring to borrowers who were in the foreclosure process as of the enactment of the Act. The Spokane District, for example, has attempted to proceed with foreclosure without even considering these borrowers for restructuring. This is particularly alarming in light of the statutory goal of restructuring as benefitting both sides. Because the FCS lender is only required to restructure if foreclosure would cost the same amount or more to that lender, the restructuring analysis should be openly completed in every case, regardless of the technical enactment date. The Spokane District's refusal to do so has resulted in litigation which is now in process and which is costly to both sides. (See Harper, et al. v. Federal Land Bank of Spokane, Civ. No. 88-449-PA (District Court; Oregon).)

Other examples of restrictive interpretation include the denial of consideration of restructuring to farmers who have filed for relief in bankruptcy (See Stainback v. Federal Land Bank of Jackson, Civ. No. GC88-25-NB-O District Court; (No. Dist. of Mississippi.) and the use of public auction sale to avoid the borrower's right of first refusal. (See Leckband, et al. v. Naylor, Civ. No. 3-88-167 (District Court; District of Minnesota.) These and numerous other examples point out the Districts' attempt to interpret the borrower's rights provisions far too narrowly. For more specific information on these abuses, please refer to comments issued by Farmers' Legal Action Group concerning the FCS Proposed Rules. These comments are attached hereto. (Extensive attachments submitted to the FCA have been deleted.)

Inconsistent Application

The second problem area concerns the inconsistent application of the law in the various districts. Because each District has been interpreting the statute to date with little or no guidance from the Farm Credit Administration, the policies are not uniform. Congress clearly intended that the borrower's rights provisions of the bill be applied fairly and consistently throughout the Farm Credit System. Individual case decisions may be left to the discussion of the various individual institutions, but the overall policy interpretation must be applied consistently throughout the country. The Congressional move to consolidate and merge many FCS institutions simply emphasizes that it intended to insure more consistent decision making within the system.

Failure to Disclose Information

The failure to disclose vital information to borrowers is the third major problem area. For example, according to the Act, each farm credit district board of directors was to establish a written restructuring policy governing the restructuring of distressed loans. The policies were issued, but they did little more than restate the statute. The actual implementation of the restructuring process appears to be governed by internal procedural manuals such as that referenced in the attached Comments. The borrower does not receive this information. As is explained therein, the actual computations of cost of restructuring and cost of foreclosure are not disclosed to the borrower until after he/she has been denied restructuring and appealed to the credit review committee. Disclosure at that point in time is too little too late.

Failure to Fulfill FCA Obligations

Each of the three problems addressed above highlights the fourth problem--the Farm Credit Administration's failure to fulfill its oversight responsibilities. In order to assure the proper implementation of the statute, FCA must assume a more active role. The problems referenced here only evidence the need for (and the lack of) supervision. This supervision must begin with the issuance of clear regulations which mandate the implementation of the borrowers' rights provisions of the statute. It must go on to assure borrowers that the regulations and the underlying statutory goals be met consistently throughout the restructuring process.

Please refer to our comments, attached to this testimony, for a more detailed discussion of each of these points.

Thank you, on behalf of our clients.

Sincerely,

FARMERS' LEGAL ACTION GROUP, INC.

James T. Massey
Attorney at Law
Executive Director

JTM/tr
Attachment

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June 10, 1988

VIA FEDERAL EXPRESS

Ms. Anne E. Dewey
General Counsel
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Re: **Comments on Proposed Rules**

Dear Ms. Dewey:

This letter contains comments on the proposed rules published by the Farm Credit Administration at 53 Federal Register 16937, May 12, 1988. These comments are submitted by the Farmers' Legal Action Group, Inc., a nonprofit law firm representing family farmers throughout the country.

Throughout the comments, periodic reference is made to the policies and procedures of the Seventh Farm Credit System District (St. Paul District). These references are provided to exemplify the difficulties that the districts are having in interpreting the Agricultural Credit Act of 1987 (the Act) and to point out interpretations which are contrary to the law. As such, the references provide concrete examples of the need for FCA to assume a more active role in the interpretation and implementation of the Act. Information regarding the specific policies of the St. Paul District is based upon a Position Paper issued by that District. Because this document is not generally available to borrowers or the public, and it may not have been submitted to FCA, a copy is attached to this letter as Exhibit I.

General Comments/Overview of Proposed Rules

The proposed rules at issue were published by the Farm Credit Administration (FCA) in response to the borrowers' rights provisions of the new Act. In this regard, the FCA Board has a clear statutory directive to issue regulations "necessary for the orderly and efficient implementation" of the new Act. (See § 901(a) of the Act.)

However, in their present form, most sections of the proposed rules merely restate the statute. This cannot be consistent with Congress's intent in directing the FCA to issue regulations. Many of the provisions of the Act are not self-explanatory, but need to be further defined in order to be of any practical use. As such, in order for FCA to properly fulfill its oversight responsibilities, the regulations must go much further in interpreting the statutory language.

This failure of the FCA to take a definitive position on the interpretation and implementation of the Act causes several major problems. First, the individual FCS Districts will continue to interpret the Act differently. Litigation is the inevitable result of this inconsistency.

Second, borrowers will remain unaware of the specific rights available to them under the statute. At present, borrowers have only the statute and the district policies (which simply restate the statute) to advise them. Neither the provisions of the Act nor the restructuring policies adequately explain the specific rights afforded to borrowers.

Third, as will be emphasized by a review of the St. Paul District procedures, without proper guidance, individual districts may not

be in compliance with the law. Again, this will result in litigation which is costly to all parties.

Finally, the regulations must require disclosure to the borrowers of their District's policies, procedures and individual determinations. In general terms, such disclosure enhances the relationship between the borrower and the lender. All too often secrecy results in mistrust. In more specific terms, perhaps the most harmful example of lack of disclosure is restructuring. There, disclosure is vital to an effective and efficient restructuring process. The Act is clear that this process is to be beneficial to both the lender and the borrower. However, only with timely and complete information can borrowers participate effectively.

As such, the entire process, including the calculation of the cost of restructuring and the cost of foreclosure, must be disclosed to borrowers during the early stages of negotiation. As is evidenced by the St. Paul District's Position Paper, such disclosure is not being made. Borrowers are being denied information regarding the lender's calculation of cost of foreclosure and cost of restructure throughout the negotiation process. Disclosure is not made until restructuring has been denied and the borrower goes before the Credit Review Committee. (See Exhibit I; p. 32; Question #9.) This is clearly contrary to the intent, if not the letter of the new Act. Moreover, it minimizes the chance that the borrower and the lender will be able to come to a mutually beneficial agreement for restructuring.

In summary, an overview of the proposed rules reveals a need for a more active and a more definitive role to be played by FCA. This is particularly the case with regard to interpreting the

statute in a clear and consistent manner and requiring District action, such as disclosure, in line with that interpretation.

With these general comments in mind, the following specific comments address individual sections of the proposed rules:

§ 614.4440 Definitions

Subpart (a) of this section defines "Adverse Credit Decision." This definition should be expanded to include the denial of a formal application for a reduced interest rate, the increase in a borrower's interest rate, and the classification of a borrower's loan as nondistressed and consequently not entitled to restructuring. Although the statute does not specifically mandate these inclusions, because each is intricately linked to the borrower's ability to meet his/her loan obligations, they are appropriate for review and within the clear intent of the statute.

Subpart (c) of this section defines "application for restructuring." This definition must be expanded and clarified so as to create a uniform, consistent procedure to be followed by all borrowers. There is no justification for different requirements and procedures to be used by different districts. Therefore, the regulations should clarify the overall policy and establish a consistent application process. Included in the definition is reference to a "preliminary restructuring plan." This reference is taken directly from the statutory language. "Preliminary restructuring plan" must also be defined to clarify the borrower's rights and obligations. Emphasis must be placed upon the concept of a "preliminary" plan. As such, clarification of the borrower's right to amend his/her plan must be included.

We recommend that the process be as follows: The lender, after determining that the borrower has a distressed loan, will send the notice of restructuring. Along with this notice will be a detailed explanation of the restructuring process, an application for restructuring, and a listing of the materials required in order to be considered for restructuring. On the application, the borrower will be expected to propose a "preliminary plan" for restructuring, but it will be explained that this plan is for discussion purposes only and can be amended as a result of meetings with the loan officer. After submission of the application, an initial meeting is scheduled between the loan officer and the borrower and, if desired, a representative of his/her choice. At this meeting, the borrower is advised of the anticipated cost of foreclosure of the loan and the cost of his/her restructuring plan. Together, the costs are analyzed to arrive at a plan which is acceptable and beneficial to both parties.

This section should also define the term "borrower" to include any person who either holds FCS collateral, has remaining FCS debt, and/or holds FCS stock.

§ 614.4441 Notice of Action on Loan Application

This regulation should be revised to require that notice of the lender's decision be provided to all primary obligers on the loan. It presently requires notice to only one. Because of the borrower's right to a review of an adverse decision and the time limit upon exercising this right, it is essential that each obliger receive proper notice.

§ 614.4443 Review Process

Subpart (b), entitled "Documentation," should be revised to include the borrower's right to present evidence regarding his/her restructuring proposal. At present, reference is made only to the loan applicant's rights. It would then be appropriate to include this subpart in the section specifically on restructuring review.

Subpart (c) deals with the borrower's right to an independent appraisal. First, from an organizational standpoint, this right should also be described in § 614.4518, Notice of Denial of Restructuring and Right of Review. At present, it is not mentioned at all in that section.

More substantively, however, there are at least two clarifications that are essential to the proper implementation of the right. These are as follows:

Assurance of an "Independent" Appraisal

The clear intent of the statute is to provide the borrower with some mechanism for challenging the appraisal used by his/her lender. Because it is in the best interests of both the borrower and the lender to have accurate information on the value of the collateral, this provision should serve to benefit both parties. As presently drafted, however, the rules do not assure the independence of the new appraiser. Without this assurance, the borrower's statutory right is meaningless.

The potential lack of independence stems in part from the failure to define the term "accredited appraiser." The confusion that Districts are faced with, and the resulting complete lack of independence, is best emphasized by the policy of the St. Paul

District. In its Position Paper, at p. 46 (see Exhibit I), the question is asked: "What is an 'accredited appraiser'?" The answer is given as follows:

> It can mean just about anything you want it to mean as long as it satisfies a judge. There is no statutory definition given for "accredited appraiser"; nor is it possible to find three people who will agree on a definition. It has never been used by Congress before, so it has never come up before. FCS has defined it as follows:
>
> > An "accredited appraiser" may be an independent contractor or a Farm Credit System employee who has demonstrated the ability to produce consistently reliable appraisals of agricultural real estate under criteria and standards established by a System institution.
>
> Information will be furnished to you on how to handle this "accredited appraiser" issue.

This answer highlights both the need for clarification of the term and the need for FCA to specifically require independence. Clearly, an FCS employee cannot produce an "independent" appraisal. To the contrary, the rules should require that the appraiser <u>not</u> be an employee or independent contractor of FCS. The term "accredited appraiser" should be defined according to the credentials of the appraiser for appraising farm property. Subpart (c)(1) should reference "accredited appraisers approved by the qualified lender but not employed by or contracting for said lender." Only with this type of provision can independence be assured. Again, because both parties benefit from accurate information, independence must be required.

When the Borrower is Entitled to an Independent Appraisal

The Act specifically states that an independent appraisal "shall be permitted if additional collateral for a loan is demanded by the qualified lender when determining whether to restructure" (§ 4.14(d)(4)). It also provides for the right to an independent appraisal as part of the credit review process. Under the statute, these two rights are separate and distinct. Yet, the regulations only indicate the credit review right. This is an error which is contrary to the law as expressed in the Act.

The regulations must be amended to insert the borrower's general right to an independent appraisal whenever additional collateral is demanded. This right is not limited by the provisions applicable to the credit review right. Therefore, the borrower is not limited to the use of one of the three "approved" appraisers. This is not the way that the St. Paul District is interpreting the Act. There, the separate, pre-credit review committee right is recognized, but the borrower is forced to use an appraiser from the lender's list of three acceptable appraisers. This policy is explained as follows:

> If FCS requires additional collateral under the restructuring, then the borrower can request an independent appraisal of all collateral. We must provide him with a list of three acceptable appraisers. He chooses one and pays for the cost of the appraisal. We must consider the results of the appraisal in making a final determination on the loan.

This limitation is not justified by the statute.

Further review of the St. Paul District's interpretation of this right reveals another problem. This concerns the definition of "demand." The following passage is informative:

> The right to an independent appraisal is a right given under the Act. We will notify the borrower of this right only at the time we demand the additional collateral. We will never give the right when the borrower proposes additional collateral in his restructuring plan (the right to an independent appraisal arises only when FCS demands additional collateral).

Because of this very restrictive definition of "demand," the regulations must clarify that the borrower is entitled to an independent appraisal whenever additional collateral is given as part of a restructuring plan. This is consistent with the intent of the statute and, again, is in both parties' best interests. It costs the lender nothing, yet provides it with additional information regarding the loan. As such, this right should not be limited.

§ 614.4444 Records

Procedures for disclosure of information to borrowers should be incorporated into this section. A process whereby borrowers can place items in their file for later review by the Special Asset Group and/or the National Special Asset Council must also be developed.

§ 614.4512 Definitions

The term "borrower" must also be defined herein. This definition should clarify that a borrower who still has FCS security property, even though his/her debt has been discharged in bankruptcy, retains status as a borrower and is entitled to restructuring. Similarly, the definition must clarify a borrower's right to restructuring even if their loan was in the process of being foreclosed prior to enactment of the statute, so long as the FCS security property remains in the possession of the borrower. The fact that these issues are already before the

courts evidences the difficulties that the Districts are having in interpreting eligibility.

The definition of "Application for Restructuring" should also be modified, consistent with comments set forth herein to § 614.4440.

With regard to "cost of foreclosure," defined in subpart (c), the proposed regulation merely restates the statute. It is imperative that more explanation be provided. Specific guidelines for each of the "costs" must be set forth. Under the present rules, the Districts are without guidance. This may result not only in inconsistent but overbroad interpretations. For example, although the statute requires restructuring if cost of foreclosure exceeds cost of restructuring, in the St. Paul District, cost is defined as including "all factors relevant to making a sound credit decision." (Seventh District Distressed Loan Restructuring Policy, Section III.) This policy is effectuated in the foreclosure costs worksheet at p. 20 of the Position Paper, Exhibit I. On that worksheet, loan officers are advised, "If foreclosure costs exceed restructure costs, explain here the appropriate credit factors which support foreclosure over restructure."

Based upon the potential for misinterpretation and inconsistency, the regulations must provide definite guidelines for the Districts to use in estimating their costs.

On the other hand, these guidelines must also ensure the individual analysis of each case, as opposed to the use of set percentage estimates. Because foreclosures and the costs associated therewith vary so greatly, the regulations must require the Districts to base their cost estimates upon actual

expenses incurred in similar situations, taking into account any unique factors presented by the borrower. Unless this is done, the decision on restructuring may well be arbitrary and capricious. See Federal Land Bank of St. Paul v. Overboe, 404 N.W.2d 445 (N.D. 1987).

With regard to the definition of distressed loan set forth in subpart (d), the lender should not have the sole authority without guidance to determine whether the borrower has the financial capacity to repay the loan. This decision is extremely critical because it may make the borrower ineligible for any restructuring consideration. For example, the St. Paul District has stated that:

> Borrowers who can pay but won't, do not meet the distressed loan definition, and we are not required to consider their loans for restructuring under the District Distressed Loan Restructure Policy.

If this determination is to be up to the lender, the borrower must receive notice and be afforded the right to submit information proving his/her distressed status. Finally, this decision must be appealable. Beyond the process, however, the regulations must provide definite guidelines for the determination. Districts and borrowers must know what criteria to use and what priority is to be put on loan obligations to FCS compared to family living expenses and other debts.

Finally, the definition of "foreclosure proceeding" should reference the point in time at which any action is taken to begin the foreclosure process.

§ 614.4514 Protection of Borrowers Who Meet All Loan Obligations

Subpart (b) of this section addresses when a lender can require a reduction in the loan principal balance in excess of the scheduled reduction. The provision regarding the borrower's sale of collateral must be revised to explain that a sale in the ordinary course of business or an otherwise authorized sale would not trigger the lender's right to demand payment.

§ 614.4516 Restructuring Procedures

This section references the policy of the lender and the "materials necessary to enable the borrower to submit an application for restructuring." It should be expanded to require that more detailed information be included in the policy. As has been noted, the present policies submitted by the Districts only restate the statute. Moreover, the "materials" should be specifically described to include detailed information on the cost of restructuring and cost of foreclosure formulas. Refer to comments on § 614.440. The notice, policy and materials must be provided to each primary obliger on a loan. Because the right to restructuring consideration will be lost if the borrower fails to make a timely application, it is essential that each borrower receive adequate notice.

Subsection (b) should be revised to require the disclosure of lender computations of cost of foreclosure and cost of restructuring regarding the borrower's loan. This disclosure should be made prior to or at the meeting with the representative, allowing the borrower time to review the computations. The borrower and the representative can then discuss the computations personally.

This section should also clarify the borrower's responsibilities in applying for restructuring. Specifically, the regulations should detail exactly what is meant by a "preliminary plan," as has already been addressed. Refer to Comments on § 614.440.

§ 614.4517 Restructuring Decision

Subpart (c) discusses the determination of whether cost of restructuring is less than or equal to cost of foreclosure. Four distinct factors are set forth for the lender to consider. Each of these factors should be described with greater specificity. At present, as has been noted previously, the regulations merely restate the statute. Of specific importance is the "present value of interest and principal forgone." This factor must be described in sufficient detail so that the individual districts arrive at not only a consistent but a reasonable interpretation. It should be emphasized that the lender should ultimately base its decisions upon whether it is cheaper for the system to restructure or foreclose. At the present time, individual districts are interpreting the "present value of interest and principal forgone" factor in such a way as to lose sight of this basic consideration. For example, in the St. Paul District, restructure costs are calculated to include all principal and interest owed, frequently computing interest at a default rate. See Exhibit I, pp. 17-18, 22, and 22a-b. This computation does not relate to the real cost of restructuring in that, by definition, the entire loan cannot be repaid. If the loan is undercollateralized, the lender will in all probability not ever be able to collect the full amount due. On this basis, the statute cannot be interpreted to call for the inclusion of all original principal and interest anticipated by the loan in cost

of restructuring. Computing cost of restructuring in that matter loses sight of the overall goal of the statute.

In summary, the FCA must issue regulations which more clearly define the statutory criteria. The only alternative will be litigation to sort out the inconsistencies and misinterpretations. Because of the tremendous costs associated with this type of complex litigation, and because some courts have previously been reluctant to take a definite stand on borrower's rights, this is a wholly unacceptable alternative. Under the specific statutory language, the responsibility for definite interpretation lies with the FCA.

§ 614.4518 Notice of Denial of Restructuring and Right to Review

This section must be modified to provide for notice to all primary obligers on the loan. Again, because of the borrower's right to seek review, and the specific time limit placed upon this right, it is essential that all borrowers receive appropriate notice.

This section should also include information on the documentation which the borrower can bring to the Credit Review Committee meeting. Similarly, this section should include information regarding the borrower's right to obtain an independent appraisal. (See comments to § 614.4443.)

§ 614.4519 Notice Before Foreclosure: Limitation on Foreclosure

Subpart (b) of this section should be revised to clarify that the lender may not initiate foreclosure proceedings before the lender has completed consideration of the loan for restructuring,

including the Credit Review Committee consideration, if applicable.

This subsection should also be revised to limit the exception to the general rule on foreclosure actions. The statutory exception is specific and sets forth very limited circumstances in which the lender can foreclose without going through the restructuring period. The regulation is much broader than the statute and, as such, is inconsistent with the intent of the Act. Although it would be helpful for the regulations to clarify what constitutes reasonable grounds to believe that the collateral will be "destroyed, dissipated, consumed, concealed, or permanently removed," the regulations should not grant more authority than that contained in the statute.

§ 614.4520 Review of Restructurings for Certified Institutions; Reporting

Included within this section should be a provision whereby the borrower can submit information to the Special Asset Group and the National Special Asset Council. Similarly, procedures should be set out by which the Special Asset Group and the National Special Asset Council review loans for restructuring.

Specific provisions must also be made for the borrower's access to the report issued by the Special Asset Group which evaluates his/her loan. Similarly, there must be disclosure of the National Special Asset Council reviews.

Finally, the regulations must clarify that foreclosures must be stayed until the review process is complete. To do otherwise is to render the review meaningless.

§ 614.4522 Right of First Refusal

The Right of First Refusal section of the statute has caused some confusion among the Districts. This confusion relates primarily to the timing of the election to sell, the sale of property at public auction, and to the definition of previous owner.

With regard to the time at which the District "first elects to sell," a definite regulation confirming this to be the acquisition date must be issued.

At present, not only is the law unclear to the Districts (and the borrowers), but the Districts are taking unfair advantage of the lack of clarity. As the St. Paul District explains:

> Because (1) we are in the selling season; (2) purchase offers are at their peak; (3) accredited appraisals are difficult to complete in a timely manner, we have revised the "first elect to sell" date from the acquisition date to the date we receive a purchase offer from a bona fide purchaser. When the selling season is over and we have in-house accredited appraisers, we may reassess this position.

This potential fluctuation in the interpretation of the date of election is impermissible. It clearly emphasizes the need for a definitive regulation. Moreover, considering the date to be the date of the receipt of a purchase offer is violative of the statutory intent to first offer the property to the previous owner at the appraised fair market value. The election to sell must be the time at which the District decides that it will attempt to sell the property. Because the Districts do not hold real estate for any period of time, this will be the time of acquisition.

With regard to the provision for a public auction of property, in order to comply with the statute, the regulations must require

all lenders to notify previous owners of the appraised fair market value of the land as soon as they elect to sell the property. This is contrary to the present wording of the proposed rules. However, as the District Court, District of Minnesota held, this right exists even if the property is to be sold at public auction. Leckband v. Naylor, Civ. 3-88-167, District Court, District of MN, Third Division; May 17, 1988. The notice should provide the previous owner with the opportunity to purchase the property at the appraised fair market price before the auction sale. The regulations should further require that notice to the previous owner of a public auction sale will always include a minimum bid acceptable to the lender.

Under the terms of the statute, if the borrower does not purchase the property at the appraised value but, rather, makes an offer to purchase it for less than the appraised value, and this offer is rejected by the lender, there are limited circumstances in which the borrower has a remaining right to purchase the property. For example, aside from state law, the borrower will not have an opportunity to match an offer which is higher than the borrower's offer. In these situations, the regulations must require that the lender disclose the purchase agreement to the borrower as proof that the requirements have been met. Without this disclosure, the borrower has no information as to whether his/her rights have been violated.

With regard to the leasing provisions, the decision to refuse to lease the property to the previous owner, based upon the lender's determination that he/she does not have the resources available, and/or cannot meet all of the payments, terms, and conditions, must be appealable. Moreover, there must be provisions for the borrower to submit evidence supporting his/her abilities and resources.

Finally, because the statute requires the lenders to also comply with the applicable state right of first refusal, the regulations should require the Districts, in consultation with the relevant State Attorney General's office and state organizations who consistently represent farm interests, to issue a statement on the interaction of the state and federal rights.

Conclusion

As is noted throughout these comments, the FCA must assume a more active role in the implementation of the Act. The Congress was clear that FCS borrowers have specific rights which must be enforced. The FCA must acknowledge its responsibility for their enforcement.

Respectfully submitted,

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lote.--Miscellaneous pages follow.

POSITION PAPER

I. INTRODUCTION

[redacted] reduce the level of non-earning loans. Phase I Restructuring concentrated on non-accrual loans and achieved its objective of getting loans from paying nothing to paying something. The emphasis was on quick turnover to increase revenues. Phase I restructuring was followed by the "backfilling" process to specifically improve the quality of the documentation and subsequently significant emphasis was placed on improving overall credit administration.

Phase II "Back to the Basics/Loan Administration" was much broader and directed attention at not only non-earning loans but placed additional emphasis on servicing loans that were earning but considered high risk. Thus it considered a much larger portion of the portfolio. Another key ingredient of Phase II was to implement a reporting system for loan restructuring activity that was tied directly to the general ledger. The result was a more accurate reflection of the financial condition of the organization and its entities.

Phase III is a continuation of Phase II with some adjustments to the parameters. New targets will be established for each service center, tied to the business plan. Phase III will retain the same name; i.e., "Back to the Basics/Loan Administration." The following excerpt from the introduction in Phase II position paper still applies:

> Every problem credit situation requires consideration of non-judicial alternatives and solutions. The advantag or disadvantages to FCS and/or the borrower are relative to the specific case, and the uniqueness of each situation.
>
> Each problem requires a realistic assessment of the condition of the business. This includes the economic condition and viability of the business, as well as the emotional condition and management ability of the owners. Some units will have the capacity to continue in business, and some should elect to discontinue. This must be the first key issue that has to be resolved in managing a problem loan situation, but this assessment needs to be made based on the facts--at least as we know them today. In those situations where there appears to be a reasonable chance for a successful continuation of the farm business, we need to make every effort to negotiate a restructuring arrangement that will maximize the economic benefits to FCS while we also minimize our overall credit risk and legal exposure.
>
> The philosophy of the Seventh District continues to be "...to relieve financial stress on customers and preserve Farm Credit Services as a viable and dependable source of credit and related services, thereby contributing to ensure continued agricultural production."

This philosophy is consistent with the District Distressed Loan Restructure Policy (Attachment I) adopted by the District Board on January 21, 1988, pursuant to the Agricultural Credit Act of 1987 (HR 3030) effective January 6, 1988 (

DISTRICT DIRECTION REGARDING THE ACT

The Act does not change the overall restructuring philosophy practiced in 1987. Settlement parameters and guidelines identified in this Phase III position paper are similar to those used in Phase II. In some cases, the Act will require deviations from these guidelines. Each situation must be dealt with case by case. As in the past, emphasis should be placed on earnings ability in determining the terms of the restructure. Expectations are to fully comply with the attached Distressed Loan Restructuring Policy. Specific directional areas as defined in the Act are:

1. FLBAs and PCAs must restructure distressed loans if the potential cost of restructuring a loan is less than or equal to the potential cost of foreclosure. District procedures for determining the cost of restructuring and the cost of forelcosure are included as Attachment II.

   It is expected that the "Cost of Foreclosure/Cost of Restructure" will be interpreted uniformly throughout the district.

   Cost of foreclosure on non-real estate property typically is the net realizable value and is determined on a case-by-case basis.

2. In determining the terms of restructure, emphasis should be placed on a realistic projection of earnings and repayment ability, supported with an analysis of historical income and expense data. Typically, projected earnings (accrual after tax earnings adjusted to credit depreciation and interest, or net cash income after tax adjusted to credit interest, as a percent of total interest and principal reduction requirements) should be 100-105%.

3. Loans that have been restructured prior to January 6, 1988, should not be restructured again unless they meet the "distressed loan" definition. (Refer to Page 1 of the Distressed Loan Restructuring Policy). If the loan is not delinquent or past due under the terms of the loan contract, the burden is on the borrower to supply the lender with sufficient financial information demonstrating that the borrower does not have the financial capacity to pay according to the terms and there is adverse financial and repayment trends before a loan has to be called distressed. Examples of adverse financial and repayment trends would be failure to pay other lenders and/or taxes.

4. Borrowers who can pay but won't, do not meet the distressed loan definition, and we are not required to consider their loans for restructuring under the District Distressed Loan Restructure Policy.

5. We are required to cancel stock in amounts equal to principal write-offs when restructuring under the law (see Act, Page 10, Sec. 4.148.) We will not cancel stock on a loan which was restructured prior to January 6, 1988, unless it is now a distressed loan and eligible for further restructuring.

[redacted]

6. The District Distressed Loan Restructuring Policy replaces the District Forebearance Policy.

[redacted] the same. Only the definition of Category 1 and 4 changes.

CATEGORY	DESCRIPTION
1	Nonaccrual unrestructured loans transferred to nonaccrual in 1988.
2	High risk accruing loans delinquent more than 30 days.
3	High risk accruing loans current or less than 30 days past due and penetrated more than 90%.
4	Non-accrual unrestructured loans that remain from 12/31/87.

II. OBJECTIVES

The objectives remain the same.

A. Significantly enhance FCS image.

B. Enhance land values.

C. Establish management controls to insure consistent implementation of the restructuring efforts.

D. Prevent other high risk loans from moving into nonearning status.

E. Minimize and control delinquency levels.

F. Maximize the overall long-term economic return to FCS.

G. Reduce FCS risk by obtaining cash payments, additional collateral and secured sources of repayment.

H. Greatly reduce the nonearning accounts which would normally become acquired property by restructuring or achieving cash settlements.

III. CHARACTERISTICS, SCOPE, STRATEGIES, AND PARAMETERS

As stated in Phase II, each category of loans has characteristics that require unique solutions. Generally speaking, the following solutions, in order of priority still apply:

A. Servicing a loan for payment is always preferred over restructuring.

B. If restructuring is the correct alternative, interest concessions in exchange for additional collateral* should be considered whenever possible. Debt set-aside agreements should be considered ahead of [illegible]

* The borrower shall be notified that an independent appraisal of all collateral shall be permitted when additional collateral for a loan is demanded by FCS in the restructuring process. Within 30 days after a request for an appraisal has been made, the service center shall present the borrower with a list of three appraisers approved by FCS from which the borrower shall select an appraiser to conduct the appraisal. The borrower shall pay the cost of the appraisal. FCS shall consider the results of the appraisal in making its restructuring determination. The borrower may waive his rights. A waiver form will be furnished by the FCS, St. Paul legal department.

C. When taking deed to the property is the alternative, gaining control of the property as soon as possible is very important.

D. Concessions from other lenders need to be explored by the borrower when there is an FCS compromise. On loan restructures, all significant creditors must be communicated with to determine if it is appropriate for them to make concessions also. This needs to be documented in the narrative in the loan package.

It should be re-emphasized over and over that servicing for payment must be more stringently applied than has been the case in the past. More specificlly, our strategy should be to anticipate the need for a servicing action rather than react to a servicing need. We have spent a lot of time and resources digging our way out of the problem of excessive levels of non-earning accounts. We have made excellent progress to date. To prevent us from staying in that reactive mode, we have to anticipate and resolve a situation before it becomes a problem. The first step in regard to this was taken in implementing a "watch list" for all adverse FLBA borrowers of $400,000 or more. Consideration now needs to be given to expand this watch list for all adverse FCS borrowers of $200,000 or more, which includes adverse PCA borrowers. These borrowers may or may not be in any of the categories above. The implementation of the "watch list" process, along with servicing plans to deal with correcting the major weaknesses, will contribute to improving loan administration in this district.

CATEGORY 1

Nonaccrual unrestructured loans transferred to nonaccrual in 1988.

Scope: This category starts out at zero -0- on January 1, 1988.

Characteristics and Strategy: Borrowers in this category may or may not have been offered alternatives to legal collections. As the "new credit process" gets implemented, assignment of all loans to individual loan officers should specifically identify who will be

responsible for handling these loans. Settlement parameters in Phase III are impacted by the Agricultural Credit Act of 1987. It is intended that we continue to emphasize interest rate concessions [illegible]

1) Restructure loans at 110% of AV (or lower if required and documented by computations performed under the Cost of Foreclosure/Cost of Restructuring analysis) at 9% interest.

2) Cash settlements at least 85% of AV (or lower if required and documented by computations performed under the Cost of Foreclosure/Cost of Restructuring analysis).

The strategies shown in Categories 2, 3 and 4 can also be applied to Category 1 loans.

Each service center management team will have to establish or re-establish individual bottomlines as appropriate based on parameter changes and requirements of the Cease and Desist Order for FLB loans. Individual loan bottomlines set below the minimums identified above will require the approval of the respective director, district producer credit/special assets. (Approval is also subject to prior approval requirements of Cease and Desist Order; i.e., FLB loans over $500,000 and adversely classified.) Because of the major effort to improve loan administration practices during 1987, we should have accurate and current borrower information. However, as time elapses, the information will become outdated. When setting or re-setting bottomlines, emphasis must continually be placed on current and accurate data. (See Attachment III, an addendum for details set out after Phase II position paper.) The bottomline setting process is a continuous process as we work our way through the entire portfolio.

CATEGORY 2

High risk accruing loans delinquent more than 30 days.

Scope: 827 loans for $57,702,499 BV.

Characteristics and Strategy: These loans remain high priority to prevent them from becoming non-accrual. As the "new credit process" gets implemented, assignment of all loans to individual loan officers should specifically identify who will be responsible for handling these loans.

The strategies shown in Categories 1, 3 and 4 can also be applied to Category 2 loans.

The objective is to service these accounts to prevent them from moving to non-accrual.

CATEGORY 3

High risk accruing loans, current or less than 30 days past due, and penetrated more than 50%.

Scope: 4,064 loans for $585,289,332 BV

Characteristics and Strategy: A majority of these acccounts have been serviced for payment; therefore, no other action was taken on them. Aggressive servicing for payment is still the best approach on these accounts. As was the case in Phase II, each case should be analyzed to determine the relative strength of the customer in terms of equity position. An audit of accounts with 'H' codes assigned revealed significant weaknesses in the individual analysis of these accounts. Particular attention should be given to improving analysis so we are not violating the integrity of the reporting process. Service plans on these accounts should identify alternative servicing actions if payments are not made. As the "new credit process" gets implemented, assignment of all loans to individual loan officers should specifically identify who will be responsible for handling these loans. We will follow the same strategies as in Phase II.

General strategies to deal with each:

The strategies shown in Categories 1, 2 and 4 can also be applied to Category 3 loans.

Owner Equity greater than 25%: These borrowers will most likely make their loan payment, but may need additional incentives to do so. Interest concessions for additional collateral may be given; however, should be in relation to the additional collateral received and inherent risk in the loan. (Additional collateral is expressed as a percent of presently existing AV.)

Additional Collateral	Interest Concessions
10%	1%
20%	2%
30%	3%

Owner Equity less than or equal to 25%: Here the prospects of additional collateral are minimal. If the borrower could pledge additional collateral, we could restructure the loan as follows:

Additional Collateral	Principal or Set Aside Write-Off		Interest Concession
10%	10%	and/or	1.0%
20%	20%	and/or	2.0%
30%	30%	and/or	3.0%

Direct write-downs combined with interest concessions may encourage family help to get collateral or cash.

[redacted] the restructure agreement (i.e., if personal property security is being pledged on a long-term loan, the repayment agreement must be adjusted to reflect the real depreciation of the asset). Values and discounts used will be consistent with the regular loan portfolio. Additional collateral includes cash payments and cross collateralization.

The maximum concession granted will not reduce the stated interest rate below 9%. Exceptions require approval of the respective director, district producer credit/special assets.

These are simply some suggested strategies and guidelines. This is not the gospel. Many of the accounts in this category will continue to be paying, accruing accounts without any incentive. Others will be moving into Category 2 and Category 1 and will have to be dealt with accordingly. Our goal is to keep these accounts on an accruing status. Good judgment must prevail as to how individual accounts are handled to accomplish this goal. This can only be done with an individual analysis of each loan.

CATEGORY 4

Nonaccrual unrestructured loans that remain from 12/31/87.

Scope: 3,925 loans for $486,720,073 (BV) million.

Characteristics and Strategy: Many of these borrowers have been offered alternatives to the legal collection process and remain unresolved. As the "new credit process" gets implemented, assignment of all loans to individual loan officers should specifically identify who will be responsible for handling these loans. Again, the emphasis is on settling. Emphasis should be placed on settling large loans first and on old Category 4 nonaccruals from 12/31/86. In Phase II it was expected that each loan in Category 4 would be settled or at least have a plan to reach settlement by December 31, 1987. As was the case in Phase II, we must initiate the legal collection process where the borrower cannot or will not reach an agreement with us. New bottomlines (as appropriate) must be set on these loans by March 31, 1988, with a plan in place or the legal collection process must be initiated. (Old Category 4 nonaccruals from 12/31/86 will be monitored closely to insure these older cases get acted on and finaled).

Cash settlements as low as 70% of appraised value should be considered for nonviable borrowers on a case-by-case basis during the bottomlining process. The actual cash settlement as a percent of appraised value allowed should be based on the Cost of Foreclosure/Cost of Restructuring analysis and documentation. The decision to cash out at a low loan to appraised value should be documented as the best economic decision, also giving consideration to subjective factors such as image in the community.

In cases where obtaining the deed is probably inevitable, cash incentives up to 10% of appraised value may be used to gain control of the asset to improve our position in renting out the land and controlling income for the 1988 crop season. That incentive will continue as long as FCS receives the income from the 1988 crop year and it makes economic sense. Normally, that incentive should be more restrictive (5% maximum) between May and September. Again in the fall, the incentive should be increased to gain control of the asset for the next peak selling season.

The strategies shown in Categories 1, 2 and 3 can also be applied to Category 4 loans.

IV. PCA NONACCRUALS

Phase II placed most of its emphasis on the FLB. However, as noted in the business plan, PCAs have target numbers for accrual and unrestructured nonaccrual assets as well. The guidelines established to date apply to the PCA portfolio, too. When the Loan Performance System (LPS) is fully implemented on the PCA loans, a similar reporting format will be used to monitor the nonaccrual portfolio.

V. FINANCIAL SUMMARY

FLBA:

	Beginning Volume	End of 2nd Quarter	12/31/88 Ending Volume (Same as Business Plan Targets)
Unrestructured Nonaccrual loans without "N" codes	$491,320,714	$350,000,000	$299,000,000

PCA:

Category	Beginning Volume	End of 2nd Quarter	12/31/88 Ending Volume (Same as Business Plan Targets)
Unrestructured Nonaccrual loans	$100,155,000	$65,000,000	$53,000,000

Individual service center ending volume targets will be negotiated on a case-by-case basis as a part of the loan/agency agreements and service center CEO performance measurements.

VI. MARKETING PLAN

As in Phase II, we do not plan any big announcements about Phase III Back to the Basics/Loan Administration. Our efforts should be strictly dedicated to sound credit administration and portfolio management. Reporting quarterly results will be the focus for 1988 as part of the quarterly financial disclosure requirements of the institutions.

[redacted]

VII. REPORTING/MONITORING

Our weekly reporting process has been an effective means to tracking progress to date. Critical to the success of the reporting process is the service center's dedication to updating information on individual borrowers via the "2516". This is an individual loan officer's responsibility and constant supervision is necessary to ensure accuracy and timeliness. To reduce costs, we will reduce the reporting to twice a month instead of every week. We will also be developing the same reporting system for the PCAs when the Loan Performance System is developed and implemented.

VIII. SUMMARY

- The guidelines and parameters were established to provide direction and focus. They are not a replacement for the CROPS manual.

- Management involvement including the CEO is a critical component of the restructuring effort as well as total portfolio management. The bottomline setting process and the quarterly review of Loan Servicing Plans on loans over $400,000 (requirement of Cease and Desist Order) will continue to require CEOs be knowledgeable of their larger credits.

- Continued use and expansion of the "watch list" process already in place under the FLB Cease and Desist requirements, with emphasis on the borrower's total FCS relationship.

- Establishing bottomlines sets direction and provides a negotiation tool. (Attachment III identifies the procedure and information requirements for setting bottom lines.) A formal credit approval and appraisal is necessary after the borrower/lender agreement has been reached.

- Documentation requirements should be consistent with district policies. Service Center management and loan officer must exercise good judgment when considering these requirements starting with strict adherence on larger credits and working down toward more liberal interpretation on smaller credits. (See CROPS 5.05)

- Analysis of information, analysis of alternatives and a comprehensive cost analysis is important.

- Amortization and payment frequency on restructured loans should be matched to the source and timing of cash. Stress legal perfection of payment sources when possible; i.e., monthly dairy loan payments, perfected dairy assignment, and crop mortgages.

- Emphasize creative use of a variety of "restructuring tools" besides debt forgiveness:

  - Interest concessions
  - Additional collateral
  - Debt set-aside agreements
  - Partial deedbacks
  - Loan fees to "buy down" interest rate

- Service centers are to operate within their assigned authority levels and these guidelines. Deviations will require the approval of the appropriate director, district producer credit/special assets.

- The Act should be adhered to in all cases, especially the specific criteria set forth for the Cost of Foreclosure/Cost of Restructuring analysis and documentation.

IX. LOAN ADMINISTRATION - AN ONGOING PROCESS

Phase III is a continuation of Phase II because sound loan administration is a continuous process. It is a process that receives critical attention as long as we have problem credits. It is also a process that should be used to avoid future build-up of problem credits.

Sound loan administration provides for early detention, early intervention, and aggressive account management of problem credits. The results of sound loan administration include "no surprises", control of portfolio risk, and current, accurate management information. More simply stated, our emphasis for Phase III continues to be servicing of our accounts.

EFC013:31
02/08/88

ATTACHMENT II

DATE: February 8, 1988

FROM: Eugene Flemming and Paul Kramp, Directors
District Producer Credit/Special Assets

RE: FORECLOSURE COSTS/RESTRUCTURE COST ANALYSIS

BACKGROUND:

The Agricultural Credit Act of 1987 placed strong emphasis on an analysis of foreclosure costs versus restructure costs in determining whether a Farm Credit lending institution may pursue foreclosure or at what level it must restructure a loan. FCS, St. Paul and individual service centers within the district have utilized such a comparative analysis in supporting foreclosure or restructure decisions. However, the recent legislation gives Farm Credit the ability to consider foregone principal and interest as a cost of restructure.

The direction, forms and procedures provided in this packet reflect the changes in the Federal Law regarding distressed agricultural loans.

DISCUSSION:

In the past, the district and service centers have compared foreclosures and restructure alternatives by comparing our expected returns at some common future point in time. That is, comparing the value of what we would receive in a foreclosure (property, deficiency judgements) versus what we would receive with a restructure (reduced principal and interest). Now, these expected returns are just part of an equation that leads us to a comparison of foreclosure costs and restructure costs. One important aspect of this new comparison is the use of present value concepts. The law clearly expects that we will analyze costs and cash flows on a present value basis to bring them back to a value in today's dollars. Utilizing relatively simple present value tables and ordinary annuity tables (a copy of this table is provided in this packet) allows us to arrive at present values with a minimum of calculations.

Since the attached forms and procedures represent a change from our past practice, we can expect questions and concerns. Key questions you may need to address up front are the following:

1. Why the change from expected returns to cost analysis?

   The new approach allows us to analyze all expected costs and expected returns in comparing foreclosure with restructure. This includes the cost of foregone principal and interest. The emphasis on present value calculations is an important part of the change as well.

2. Why are there differences between the foreclosure cost and restructure cost analyses?

   The difference in format exists primarily to accommodate the fact that the law allows us to recognize the present value of foregone principal and interest as a restructure cost. The law doesn't provide for the same cost in the foreclosure analysis.

Although the format may be somewhat different, both begin with our original investment and consider the present values of expected returns and expected costs to arrive at a net foreclosure cost or restructure cost figure.

Please provide us with additional questions which you or your staff raise or hear from borrowers. They will help us prepare other service centers as they deal with the same questions and concerns. Finally, the attached forms, procedures and examples deal only with level payment fully amortized loans (original and restructured). In the very near future we expect to have forms, procedures and examples for loans with level principal payments.

If you have questions concerning the use of these forms and procedures, please do not hesitate to contact us, your St. Paul credit contact or Keven Smith.

KDS/jw:32

INDEX

Index 19

Foreclosure

Worksheet 20
Procedure 20a
Example 20b

Cashout/Deedback

Worksheet 21
Procedure 21a
Cashout Example 21b
Deedback Example 21c

Restructures

Level Payment - Worksheet 22
Level Payment - Procedure 22a-b
Level Payment - Example 22c

Level Payment & Partial Deedback - Procedure 22d
Level Payment & Partial Deedback - Example 22e

Level Payment & Debt Set Aside - Procedure 22f
Level Payment & Debt Set Aside - Example 22g

FORECLOSURE COSTS

WORKSHEET

MEMBER VIEW $_____

PRINCIPAL $_____

INTEREST $_____

			COSTS
1. INVESTMENT			$_____
2. ADD: COSTS			
A) TAXES	$_____		
B) DISPOSITION COSTS	$_____		
C) LEGAL	$_____		
D) INSURANCE AND REPAIR	$_____	$_____	
3. TOTAL INVESTMENT			$_____
4. LESS: RECOVERABLE ASSETS			
A) STOCK	$_____		
B) AV OF PROPERTY X (.8780) NPV	$_____		
C) OTHER RECOVERABLE ASSET (PV)	$_____	$_____	
5. FORECLOSURE COSTS			$_____

COMMENTS: IF FORECLOSURE COSTS EXCEED RESTRUCTURE COSTS, EXPLAIN HERE THE APPROPRIATE CREDIT FACTORS WHICH SUPPORT FORECLOSURE OVER RESTRUCTURE

PROCEDURE

1. **INVESTMENT** - This line shows our total investment to date, including all expenses advanced and accrued interest.

2. ADD: COSTS -

   a) **TAXES** - This represents all past due taxes (excluding those advanced and shown above in Line 1) and two years of estimated future taxes.

   b) **DISPOSITION COSTS** - This represents our anticipated sales costs. Based on projections and experience in acquired property sales, this is a flat 3% of appraised value. Calculation: AV X 3%

   c) **LEGAL** - Again, these are anticipated legal expenses which are not already included in Line 1. We expect 1-2% of AV for legal expenses; however, your legal expense levels must be based on individual service center experience.

   d) **INSURANCE AND REPAIR** - Enter estimated insurance and repair expenses during the foreclosure process.

3. **TOTAL INVESTMENT** - This represents our investment after adding the foreclosure costs FCS faces in a foreclosure action. Please note that the added costs are not calculated on a net present value basis. The timing of expenses is so varied, including many front-end expenses, such that a present value calculation would require an inordinate amount of time and would show only a slight impact on the costs presented.

4. LESS: RECOVERABLE ASSETS

   a) **STOCK** - Enter the current amount of stock held by the borrower. Remember that on a foreclosure in process stock may have been applied as a reduction in the investment amount (Line 1). If that is the case, Line 4a should be zero.

   b) **AV OF PROPERTY** - This line represents the present value of the property we would recover in foreclosure. We recommend calculating an amount by multiplying the appraised value of the property by a .8780 discount factor (based on a 9% discount rate over one and a half years). However, if the loan officer has strong evidence that the property value will change (up or down), you may use the present value of the appreciated or depreciated property. Also, the length of foreclosure may vary if properly supported.

   c) **OTHER RECOVERABLE ASSETS** - This line includes the present value of any other assets we could recover in the foreclosure process, including the value of any deficiency judgments. The asset should reflect present values.

5. **COST OF FORECLOSURE** - This line represents the cost of foreclosure for comparison with restructuring costs. It is calculated by subtracting the Total Recoverable Assets from Total Investment. Line 3 - (Lines 4a + 4b)

COMMENTS - If foreclosure costs exceed restructure costs, explain here the appropriate credit factors which support foreclosure over restructure. This section must address factors supporting foreclosure such as:

a) borrower applying all available income to the payment of primary obligations
b) borrower's financial capacity and management skills to protect collateral
c) borrower's capacity to work out of existing financial difficulties

FORECLOSURE COSTS

EXAMPLE

Member View	$317,363
Principal	232,760
Interest	84,603

			COSTS
1.	Investment		$317,363
2.	ADD: Costs		
	a) Taxes	$ 7,849	
	b) Disposition costs	3,660	
	c) Legal	2,000	
	d) Insurance and repair	1,800	15,309
3.	Total investment		332,672
4.	LESS: Recoverable assets		
	a) Stock	11,750	
	b) AV of property x (.8780) (PV) ($122,000 AV)	107,116	
	c) Other recoverable asset (PV)	0	118,866
5.	Compromise/Foreclosure Costs		$213,806

COMMENTS - If foreclosure costs exceed restructure costs, explain here the appropriate credit factors which support foreclosure over restructure.

CASHOUT/DEEDBACK COSTS

WORKSHEET

1. CASHOUT/DEEDBACK TERMS

A. CASH	_____	
B. STOCK	_____	
C. OTHER CONSIDERATIONS	_____	
D. TOTAL CONSIDERATIONS	_____	
		COSTS
2. PRESENT INVESTMENT		_____
3. LESS: CONSIDERATIONS		
A. CASH	_____	
B. STOCK	_____	
C. OTHER CONSIDERATIONS	_____	_____
4. ADD: OTHER RESTRUCTURING COSTS		
A.	_____	
B.	_____	
C.	_____	_____
5. CASHOUT/DEEDBACK COSTS/COMPROMISE		_____

CASHOUT/DEEDBACK COSTS

DEFINITIONS/PROCEDURES

1. CASHOUT TERMS

   a. CASH - Enter the cash amount to be paid by the borrower in return for compromise of our loan and release of our security.

   b. STOCK - Enter the amount of stock applied against the loan.

   c. OTHER CONSIDERATIONS - Enter any other considerations provided ~~by the~~ borrower which add to our monetary returns. This most commonly will involve real estate or chattel property deeded to FCS. All values entered under other considerations must reflect recovery values and should be present valued if we receive them at some time in the future.

   d. TOTAL CONSIDERATIONS - On this line show the total of cash stock and other considerations the borrower is applying to the outstanding debt. (Line 1a plus Line 1b plus Line 1c)

2. PRESENT INVESTMENT - This line reflects the total member view investment, including all fees and expenses that have been added to the loan.

3. LESS: CASHOUT TERMS

   a. CASH - Again, enter the cash paid by the borrower in the compromise. From Line 1a.

   b. STOCK - Enter the stock amount shown on Line 1b here as well.

   c. OTHER CONSIDERATIONS - Enter the present value of the recovery values of other considerations from the borrower. From Line 1c. The total of Line 3a plus Line 3b plus Line 3c is entered in the right hand column.

4. ADD: OTHER RESTRUCTURING COSTS - Enter any out-of-pocket restructuring costs not included in the Present Investment amount (Line 2) above. The sum of all Other Restructuring Costs is entered in the right hand column.

5. CASHOUT/DEEDBACK COSTS / COMPROMISE - Enter the results of the combination of all values in the right hand column.
   (Line 2 minus Line 3 plus Line 4) = Cashout Costs/Compromise

CASHOUT/DEEDBACK COSTS

CASHOUT EXAMPLE

1. CASHOUT/DEEDBACK TERMS		
A. CASH	$135,000	
B. STOCK	11,750	
C. OTHER CONSIDERATIONS		
D. TOTAL CONSIDERATIONS	146,750	
		COSTS
2. PRESENT INVESTMENT		317,363
3. LESS: CONSIDERATIONS		
A. CASH	135,000	
B. STOCK	11,750	
C. OTHER CONSIDERATIONS		146,750
4. ADD: OTHER RESTRUCTURING COSTS		
A.		
B.		
C.		0
5. CASHOUT/DEEDBACK COSTS/COMPROMISE		$170,613

CASHOUT/DEEDBACK COSTS

DEEDBACK EXAMPLE

1. CASHOUT/DEEDBACK TERMS			
A. CASH	$ 10,000		
B. STOCK	11,750		
C. OTHER CONSIDERATIONS (NRV)	109,800	(AV $122,000)	
D. TOTAL CONSIDERATIONS	131,550		
			COSTS
2. PRESENT INVESTMENT			$317,363
3. LESS: CONSIDERATIONS			
A. CASH	10,000		
B. STOCK	11,750		
C. OTHER CONSIDERATIONS	109,800		131,550
4. ADD: OTHER RESTRUCTURING COSTS			
A.			
B.			
C.			0
5. CASHOUT/DEEDBACK COSTS/COMPROMISE			$185,813

RESTRUCTURE COSTS - LEVEL PAYMENTS
WORKSHEET

1. RESTRUCTURE TERMS
   - A) PRINCIPAL $_____
   - B) CASH _____
   - C) STOCK _____
   - D) OTHER CONSIDERATIONS _____
   - E) TOTAL CONSIDERATIONS $_____
   - F) INTEREST RATE/TERMS _____

2. PRESENT INTEREST FORGIVEN — COSTS
   - A) PRESENT INTEREST $_____
   - B) LESS: CASH PAYMENT _____
   - C) LESS: STOCK _____
   - D) LESS: OTHER CONSIDERATIONS _____ $_____

3. PRESENT VALUE OF FOREGONE PRINCIPAL AND INTEREST
   - A) ORIGINAL PAYMENT X PVF $_____
   - B) LESS: RESTRUCTURED PAYMENT X PVF _____ $_____

4. PRESENT VALUE OF INTEREST CONCESSIONS
   - A) RESTRUCTURED PAYMENT AMOUNT $_____
   - B) LESS: CONCESSION PAYMENT AMOUNT _____
   - C) FOREGONE ANNUAL PAYMENT AMOUNT _____
   - D) TIMES: PRESENT VALUE FACTOR X_____ $_____

5. OTHER RESTRUCTURE COSTS
   - A) $_____
   - B) _____ $_____

6. COMPROMISE/RESTRUCTURE COSTS $_____

RESTRUCTURE COSTS - LEVEL PAYMENTS

PROCEDURES/DEFINITIONS

1. **RESTRUCTURE TERMS -**

   a) **PRINCIPAL** - This line shows the principal balance of the loan after the restructure is completed and accounted for.

   b) **CASH** - Enter any cash payment received.

   c) **STOCK** - Enter the value of all stock reductions which are applied to the loan in the restructure.

   d) **OTHER CONSIDERATIONS** - This category includes any other monetary considerations received for the restructure, including up-front cash, set aside loans or net recovery value of collateral deeded to FCS. In complex restructures, loan officers have the option to add lines (d, e, f ...) if necessary to clarify the restructure terms. Do not include the value of additional collateral as other considerations.

   e) **TOTAL CONSIDERATION** - This line is the sum of Lines 1a, 1b, 1c and 1d.

   f) **INTEREST RATE/TERMS** - This line briefly defines the interest rates charged on the restructured loan, including any concessionary rates (and their duration). It also should identify the term of the restructured loan. This format is for level payments.

2. **PRESENT INTEREST FORGIVEN** - The Agricultural Credit Act of 1987 provides Farm Credit institutions with the ability to consider foregone principal and interest as part of its Restructure Costs. This section identifies the cost associated with present interest forgiven.

   a) **PRESENT INTEREST** - Enter the present interest balance.

   b) **LESS: CASH PAYMENT** - Enter any cash payment (if any) intended to be a payment of interest. Show the net of Lines 2a and 2b under the "Cost" column.

   c) **LESS: STOCK** - Enter the value of any stock applied to the loan as part of the restructure.

   d) **LESS: OTHER CONSIDERATIONS** - Enter the value of other considerations identified on Line 1d. Enter the result of Lines 2a minus 2b minus 2c minus 2d in the right hand column.

3. **PRESENT VALUE OF FOREGONE PRINCIPAL AND INTEREST** - This section evaluates the present value of foregone principal and interest by comparing the present value of the original loan with the present value of the restructured loan. We use the present value of an annuity concept (annual payments over a defined period of time) to determine the present value of a flow of equal payments. The difference is foregone for the life of the loan.

   a) **ORIGINAL AMOUNT** - Enter the result of the original payment amount times the appropriate present value factor (PVF) to show the present value of the original loan.

b) LESS: RESTRUCTURED AMOUNT - This line begins with a restructured payment amount which is calculated from the restructured principal amount and the general interest rate that would apply to the loan without any interest rate concessions. Enter the result of the restructured payment times the appropriate present value factor to show the present value of the restructured loan. Subtract this amount from the result in Line 3a and enter this difference in the right hand column.

4. PRESENT VALUE OF INTEREST CONCESSIONS - There are costs associated with interest concessions which can be calculated on a present value basis. These calculations are less exact, but provide a sound approximation of the cost of an interest rate concession. Use this only when offering a concessionary interest rate for part of the loan term.

   a) RESTRUCTURED PAYMENT AMOUNT - Enter the same payment amount as shown on Line 3b.

   b) LESS: CONCESSION PAYMENT AMOUNT - Enter the payment amount based on the concessionary interest rate and the term of the concessionary rate.

   c) FOREGONE ANNUAL PAYMENT AMOUNT - Enter the difference between Line 4a and 4b on this line.

   d) TIMES: PRESENT VALUE FACTOR - Multiply the result on Line 4c by appropriate present value factor based on the interest rate concession and the length of the concession. Show the results of this calculation under the "Cost" column. (We are using a present value of an annuity table - further directions will be provided in the final draft.)

5. OTHER RESTRUCTURE COSTS - Recognizing there may be additional out of pocket costs for the Farm Credit lender in restructuring a loan, this section allows for consideration of those costs. Most will likely be up-front costs and, therefore, no present value calculations are necessary. Show the total other restructure costs under the "Cost" column.

6. COMPROMISE/RESTRUCTURE COSTS - Add the costs for each section and show the total at Line 6 under the "Cost" column.

RESTRUCTURE COSTS - LEVEL PAYMENTS

EXAMPLE

1.	Restructure terms		
	a) Principal	$141,750	
	b) Cash	11,000	
	c) Stock	11,745	
	d) Other considerations	0	
	e) Total considerations	164,495	
	f) Interest rate/terms	9% for 5 years, variable thereafter, 20 year amortization	
			COSTS
2.	Present interest charged off		
	a) Present interest	$ 84,603	
	b) LESS: cash payment	11,000	
	c) LESS: stock	11,745	
	d) LESS: other considerations	0	61,858
3.	Present value of foregone principal and interest		
	a) Original payment X PVF (29,963 X 9.129)	273,532	
	b) LESS: restructured payment X PVF (18,978 X 9.129)	173,250	100,282
4.	Present value of interest concessions (3%, 5 years)		
	a) Restructured payment amount	18,978	
	b) LESS: Concession payment amount	15,528	
	c) foregone annual payment amount	3,450	
	d) TIMES: present value factor	x 3.890	13,421
5.	Other restructure costs		
	a)	0	
	b)	0	0
6.	Compromise/Restructure Costs		$175,561

RESTRUCTURE WITH A PARTIAL DEEDBACK

PROCEDURE

The restructure cost worksheets will accommodate a restructure that includes a partial deedback of property as part of the consideration FCS receives in a restructure. Full deedbacks are best analyzed using the Cashout/Deedback worksheet. In partial deedback cases, follow these directions in conjunction with the basic Restructure (Level Payment) procedures.

1. RESTRUCTURE TERMS

   d. OTHER CONSIDERATIONS - Enter the recovery value of all real estate or chattel property received from the borrower in the proposed restructure.

2. PRESENT INTEREST CHARGED OFF

   d. LESS: OTHER CONSIDERATIONS - Enter the recovery value of real estate or chattel property received from the borrower. From Line 1d. This amount reduces the interest charged off in the restructure.

GENERAL - All other calculations and procedures remain the same.

RESTRUCTURE COSTS

PARTIAL DEEDBACK EXAMPLE

1. RESTRUCTURE TERMS		
A) PRINCIPAL	$ 141,750	
B) CASH	0	
C) STOCK	11,745	
D) OTHER CONSIDERATIONS	10,800 (NRV) (AV=$12,000)	
E) TOTAL CONSIDERATIONS	164,295	
F) INTEREST RATE/TERMS	9% for 5 years; variable thereafter; 20 year amortization	

		COSTS
2. PRESENT INTEREST CHARGED OFF		
A) PRESENT INTEREST	$ 84,603	
B) LESS: CASH PAYMENT	0	
C) LESS: STOCK	11,745	
D) LESS: OTHER CONSIDERATIONS	10,800	$ 62,058
3. PRESENT VALUE OF FOREGONE PRINCIPAL AND INTEREST		
A) ORIGINAL PAYMENT X PVF (29,963 X 9.129)	273,532	
B) LESS: RESTRUCTURED PAYMENT X PVF (18,978 X 9.129)	173,250	100,282
4. PRESENT VALUE OF INTEREST CONCESSIONS		
A) RESTRUCTURED PAYMENT AMOUNT	18,978	
B) LESS: CONCESSION PAYMENT AMOUNT	15,528	
C) FOREGONE ANNUAL PAYMENT AMOUNT	3,450	
D) TIMES: PRESENT VALUE FACTOR	X 3.890	13,421
5. OTHER RESTRUCTURE COSTS		
A)		
B)		0
6. COMPROMISE/RESTRUCTURE COSTS		$175,761

RESTRUCTURE WITH A DEBT SET ASIDE

PROCEDURE

The restructure cost worksheet will accommodate a restructure that includes a debt set aside loan as part of the consideration FCS receives in a restructure. Typically, a debt set aside loan is one on which we will receive no interest for a specified period of time. Because of this, the loan's value today is something less than the face amount. To arrive at today's values, we apply present value concepts by multiplying the face amount by the present value factor (present value table) corresponding to the number of years we receive no interest.

1. **RESTRUCTURE TERMS**

   d. **OTHER CONSIDERATIONS** - In cases with set aside debt, use this line to enter the present value of the set aside debt. To determine the present value, multiply the face value of set aside debt by a present value factor from the present value table. All factors from this table are equal to or less than one to reflect discount associated with not receiving interest for a period of years. The appropriate present value factor is determined by finding the factor that corresponds to the number of years before we receive cash for the set aside debt or interest on it. Be certain your narrative summary of the proposal clearly identifies the face value of the debt.

2. **PRESENT INTEREST CHARGED OFF**

   d. **LESS: OTHER CONSIDERATIONS** - Enter the present value of set aside debt from Line 1d above. This present value of set aside debt reduces the interest charged off in the restructure.

GENERAL - All other calculations and procedures remain the same.

RESTRUCTURE COSTS

DEBT SET ASIDE EXAMPLE

1.	RESTRUCTURE TERMS		
	A) PRINCIPAL	$141,750	
	B) CASH	0	
	C) STOCK	11,745	
	D) OTHER CONSIDERATIONS $50,000	21,100 PV	
	E) TOTAL CONSIDERATIONS	174,595	
	F) INTEREST RATE/TERMS	9% for five years, variable thereafter; 20 year amortization on primary note; set aside debt reinstated at variable interest in ten years.	
			COSTS
2.	PRESENT INTEREST CHARGED OFF		
	A) PRESENT INTEREST	$ 84,603	
	B) LESS: CASH PAYMENT	0	
	C) LESS: STOCK	11,745	
	D) LESS: OTHER CONSIDERATIONS	21,100	$ 51,758
3.	PRESENT VALUE OF FOREGONE PRINCIPAL AND INTEREST		
	A) ORIGINAL PAYMENT X PVF	273,532	
	B) LESS: RESTRUCTURED PAYMENT X PVF	173,250	100,282
4.	PRESENT VALUE OF INTEREST CONCESSIONS		
	A) RESTRUCTURED PAYMENT AMOUNT	18,978	
	B) LESS: CONCESSION PAYMENT AMOUNT	15,528	
	C) FOREGONE ANNUAL PAYMENT AMOUNT	3,450	
	D) TIMES: PRESENT VALUE FACTOR	X 3,890	13,421
5.	OTHER RESTRUCTURE COSTS		
	A)		
	B)		0
6.	COMPROMISE/RESTRUCTURE COSTS		$165,461

BORROWER RIGHTS UNDER THE AGRICULTURAL CREDIT ACT OF 1987

Questions and Answers

Restructuring

Question #1 Do we now have a forbearance and restructuring policy?

Restructuring Policy No. We only have a restructuring policy. The Act deleted the reference to the 1985 Amendments which required a forbearance policy (§4.13). (See Sec. 103 and 109 of the Act which amended §4.13 in its entirety [page 12 of H.R. 3030].) There is no longer any statutory reference to a forbearance policy. As for the regulations, Title IX, Sec. 901(b)(2) (page 151 of H.R. 3030) states that all regulations on borrower's rights remain in effect until January 1, 1989, unless contrary to the Act. The regulations are contrary to the Act because the Act requires a 45 day* notice (hereinafter called the "45 day letter") before foreclosing and the regulations state that you cannot begin foreclosure after 30 days have passed from the date of receipt of the foreclosure policy. The Act requires a minimum of 45 days, the regulations allow a maximum of 30 days, hence they are contrary and do not apply.

#2 In one sentence, please.

Forbearance Policy From this day forward, you shall [redacted] Forbearance Policy to a borrower. You will only send the Restructuring Policy.

#3 What does the borrower get in addition to the Restructuring Policy?

Materials Sent To Borrower (1) The memo dated January 27, 1988 to service center CEOs entitled "Distrissed Loan Restructuring Policy" from Jim Cannon outlines the requirements. The requirements include:

- The District Distressed Loan Restructuring Policy
- Application for Loan Restructure (Form 20300)
- Completion of balance sheet information
- Three years income tax records
- Realistic income and expense projection
- Credit investigation authorization
- Other documents needed by the service center.

*All references to 45 days are to be read "48 days" because we are allowing 3 days for mail delivery. The notice does not have to be sent certified mail, we do, however, recommend an affidavit of mailing (attached).

(2) Cover Letter (also prepared by St. Paul) - You are free to add anything you wish but the guts St. Paul drafted should remain.

#4 **May an association revise the Restructuring Policy?**

Restructuring Policy - Changes

No. The Act requires that "Each farm credit district board" shall develop a "[restructuring] policy." No changes allowed.

#5 **What are the time schedules in addition to the 45 days?**

Time Schedules

The Act says that not later than 45 (48) days before a lender begins foreclosure proceedings, the lender shall notify the borrower that the loan may be suitable for restructuring. It doesn't say the borrower has to have his form and schedules submitted within "20 days" or some other time period. It just says "hold up for 45 (48) days." Since one purpose of this Act is to give all ties to the borrower, we have decided that he has 45 (48) days to get his application and materials in, but we encourage an earlier application in the cover letter. An earlier application means more time to review before the 45 day period expires. However, if he does get his application in on day 45 (48), we will consider the application as being timely received. Exhibit A gives some examples on how to handle various situations.

#6 **If no application is submitted?**

On the 46th (49th) day, foreclosure action can commence.

#7 **What if he sends in an application but no forms or supporting documents such as tax returns?**

Incomplete Documentation Sent In

We must let him know when the application comes in without supporting data that the application is insufficient and cannot be acted upon until the supporting data is received. If he does not respond to your request, then foreclosure can begin on the 46th (49th) day. Now, if he sends the application in on day 44 (47) without supporting data, good judgment says we don't foreclose on day 46 (49) but the review time past day 45 (48) may be accelerated. In other words, allow a reasonable time to submit additional data (i.e. one week).

#8 He is entitled to a meeting with a representative of the service center. Who schedules the meeting? Can he ask for it before his application is received?

Meeting With Loan Officer

The service center schedules the meeting. It would seem a futile to schedule the meeting before his application is in. This raises, of course, the question of having the application come in on day 45 (48) with a request for a meeting on day 50 (53). If this happens, oblige him.

At the meeting, the borrower is entitled to a review of the status of the loan, his financial condition (as seen by the service center), and the suitability of the loan for restructuring. If the loan is a non-accrual and suitable for restructuring, restructuring should be accomplished.

#9 If restructuring is denied, in the denial letter do we give the borrower the numerical calculations made by FCS?

Numerical Calculations to Borrower

No. These are best left to review and discussion at a credit review meeting. He should be given the "numbers" then.

#10 What are his credit review rights?

Credit Review

After a denial of restructuring, a borrower may request credit review in writing within 7 days after receiving the denial in writing.

The credit review date may be established at the discretion of the service center. At the review, the borrower may bring in an attorney or any other representative to seek a reversal of the decision.

Because of the specific restructuring requirements set forth in the Act, it is anticipated that the borrower or representative will question how FCS arrived at the "numbers" and conclusions we did.

#11 If the loan is not distressed but delinquent, do we still have the 45 day requirement?

The Act (§4.14A(b)(2)) says "not later than 45 days before any qualified lender begins foreclosure proceedings with respect to a loan..." It does not say "distressed loan," although the heading to the section reads "Restructuring Distressed Loans." Since it is unclear whether the 45 days applies to all loans or just distressed loans, under the Congressional rule that all ties go to the borrower, we are

saying that delinquent but not distressed loans get the 45 days.

#12 Does he get any other notice?

notice is required other than required state foreclosure notices.

#13 Does all this apply to personal property replevin actions?

Personal Property

Yes.

#14 Bow about rural housing loans?

Rural Housing Loans

No. If it isn't a loan to a farmer, rancher, or producer for an agricultural purpose, it does not qualify for the "45 day notice." However, when the rural housing loan is to a farmer we are interpreting the law to mean "all distressed loans to farmers" and will give the borrower the same notice as for an agricultural loan.

#15 What does "restructure" include?

Definition of Restructure

a) Rescheduling
b) Reamortization
c) Renewal
d) Deferral of principal or interest
e) Monetary concessions (principal or interest)
f) Any action that modifies terms or forbears on a loan.

In considering restructuring there are three areas that Congress specifically set forth with very specific criteria. These are:

a) "Cost of Foreclosure. - The term "cost of foreclosure" includes-
   (A) the difference between the outstanding balance due on a loan made by a qualified lender and the liquidation value of the loan, taking into consideration the borrower's repayment capacity and the liquidation value of the collateral used to secure the loan;
   (B) the estimated cost of maintaining a loan as a nonperforming asset;
   (C) the estimated cost of administrative and legal actions necessary to foreclose a loan and dispose of property acquired as the result of the fore-

[redacted]

closure, including attorneys' fees and court costs;

(D) the estimated cost of changes in the value of collateral used to secure a loan during the period beginning on the date of the initiation of [redacted] ending on the date of the disposition of the collateral; and

(E) all other costs incurred as the result of the foreclosure or liquidation of a loan."

b) "Computation of Cost of Restructuring. - In determining whether the potential cost to the qualified lender of restructuring is less than or equal to the potential cost of foreclosure, a qualified lender shall consider all relevant factors, including -

(A) the present value of interest income and principal forgone by the lender in carrying out the restructuring plan;

(B) reasonable and necessary administrative expenses involved in working with the borrower to finalize and implement the restructuring plan;

(C) whether the borrower has presented a preliminary restructuring plan and cash-flow analysis taking into account income from all sources to be applied to the debt and all assets to be pledged, showing a reasonable probability that orderly debt retirement will occur as a result of the proposed restructuring; and

(D) whether the borrower has furnished or is willing to furnish complete and current financial statements in a form acceptable to the institution."

c) "Consideration of Applications -

(1) In General. - When a qualified lender receives an application for restructuring from a borrower, the qualified lender shall determine whether or not to restructure the loan, taking into consideration -

(A) whether the cost to the lender of restructuring the loan is equal to or less than the cost of foreclosure;

(B) whether the borrower is applying all income over and above necessary and reasonable living and operating expenses to the payment of primary obligations;

(C) whether the borrower has the financial capacity and the management skills to

[redacted]

protect the collateral from diversion, dissipation, or deterioration;

(D) whether the borrower is capable of working out existing financial difficulties, reestablishing a viable operation, and repaying the loan on a rescheduled basis; and

(E) in the case of a distressed loan that is not [redacted] with sound lending practices may be taken to reasonably ensure that the loan will not become a loan that is necessary to place in nonaccrual status.

(2) Applications Not Required for Restructuring Plans. - This section shall not prevent a qualified lender from proposing a restructuring plan for an individual borrower in the absence of an application for restructuring from the borrower." District procedures for calculating the cost of foreclosure and cost of restructuring are being sent in a separate memo."

#16 What if the borrower is destroying or concealing collateral?

Collateral-Destroying, Concealing

If we have evidence or a good faith belief that this is occurring we can proceed to foreclosure or take other protective action without giving the 45 day notice. The law allows us to do this if the borrower is:

a) destroying
b) dissipating
c) consuming
d) concealing
or
e) permanently removing the collateral from the state.

#17 What if we are in mediation, either by agreement or state law, and the loan is distressed before January 6, 1988?

Loan In Process of Discussing Restructuring as of January 6, 1988

Believe it or not, this was one of the few things the Act spelled out so that no one disagrees (the Act was unclear on two of the largest issues - did it apply to pending foreclosures and did it apply to acquired inventory as of January 6, 1988).

In this case, the Act said that the 45 day wait and opportunity for meeting are not required if the loan was distressed before January 6, 1988 and the borrower and lender were in the process of negotiating loan restructuring. Ironically, this means that if the borrower and lender were in the process of negotiating, the law was clear that "45 days" and a meeting were not required, but if they were beyond that process and into foreclosure, the law was very unclear as to whether the notice was required.

[redacted]

#17A Mediation/ Negotiation in process January 6, 1988	The restructuring policy does not address the situation where (1) we may be negotiating/mediating (by statute or voluntarily); (2) negotiations do not result in restructuring; (3) we want to foreclose without giving 45 days notice or having additional meetings. How do we handle then?

[redacted] required by the Act, the cover letter to the restructuring policy should read as follows:

1988

Address

RE: FLB Loan No.

Dear Mr. and Mrs.

On January 6, 1988 Congress enacted the Agricultural Credit Act of 1987. Included in the law are provisions that require Farm Credit institutions to provide a notice to borrowers at least 45 days before beginning foreclosure proceedings that their loan may be suitable for restructuring and that a borrower who files an acceptable restructuring application will be provided a reasonable opportunity to personally meet with a representative of the lending institution.

However, these requirements do not apply to any loan that became a distressed loan before January 6, 1988 if the borrower and lender were in the process of negotiating restructuring on January 6, 1988. Because your loan was being considered for restructuring on January 6, 1988, the restructuring requirements relating to a 45-day notice period and an opportunity to meet with our representative are not applicable to your loan. Nevertheless, the Federal Land Bank Association of _____ will consider a request for restructuring provided that you submit an application within ten (10) days of the date you receive this letter.

Attached is a copy of the Seventh Farm Credit District's distressed loan restructuring policy and the forms necessary to complete and submit an application for restructuring. I suggest that you read the policy and the forms carefully before submitting an application. We will review any suitable loan for restructuring only if an application is submitted within the time period designated above. To be complete, an application for restructuring must include the following completed forms: (forms are enclosed)

1. Application for Restructure
2. Balance Sheet - current within sixty (60) days
3. Request for Credit Information - completed only where indicated
4. 1985 and 1986 Tax Returns (if not already provided)
5. 1987 Tax Return when available

Your application, or any questions you have regarding restructuring, should be directed to (L.O. and address) at (telephone number).

Sincerely,

Enclosures
cc: Branch Office

#18 How about FLBA or PCA stock?

Stock - Application to loan — If any principal is forgiven, it is taken from the stock portion of the loan first until the stock loan (and the stock) is reduced to [illegible]

For example, if PCA:

$60,000	green dollar loan
6,000	stock loan (rounded to 000)
6,000	stock held (rounded to 000)
10,000 of principal is forgiven	

result:

$55,995	restructured green dollar loan
5	stock loan
5	stock held

Summary:

$5,995 of stock loan written off
4,005 of green dollar loan written off

The $5 remains because the Act says that the borrower shall be entitled to retain at least one share of stock to maintain membership and voting rights.

If the FLB:

$63,000 loan
3,000 FLBA stock held (rounded to 000)
10,000 of principal forgiven

result:

$53,000 restructured loan
5 FLBA stock held

Summary:

$10,000 loan written off
2,995 FLBA stock written off

FLBA reduces stock held in FLB by $2,995.

#19 How does FmHA fit into restructuring?

FmHA

The Act says it is a sense of Congress that FCS should use loan guarantee programs of FmHA and other state and federal programs that offer relief to financially distressed farmers.

#20 How about appraisals?

Appraisals

If FCS requires additional collateral under the restructuring, then the borrower can request an independent appraisal of all collateral. We must provide him with a list of three acceptable appraisers. He chooses one and pays for the cost of the appraisal. We must consider the results of the appraisal in making a final determination on the loan.

The right to an independent appraisal is a right given under the Act. We will notify the borrower of this right only at the time we demand the additional collateral. We will never give the right when the borrower proposes additional collateral in his restructuring plan (the right to an independent appraisal arises only when FCS demands additional collateral). The notice will come in your letter relating to the restructuring and the demand for additional collateral as follows:

> "The Farm Credit Act §4.14(d) provides for an appraisal when we demand additional collateral. The section reads as follows:
>
> > "An independent appraisal shall be permitted if additional collateral for a loan is demanded by the qualified lender when determining whether to restructure the loan."
>
> Within 30 days after you request an appraisal, we shall present you with a list of three appraisers from which you shall select an appraiser to conduct the appraisal. You are responsible for the cost of the appraisal, and we shall consider the results of the appraisal in any final determination we make with respect to your loan. A copy of the appraisal shall be provided to the you."

#21 What about contracts for deed, land contracts?

Contracts for Deeds, Land Contracts

Credit sales such as land contracts are not loans and are not subject to the restructuring requirements under the Act. Therefore, cancellations of contracts can be done without giving the 45 day letter.

#22 If we do not foreclose but rather sue on the note, do we have to give the rights under the Act?

Sue on Note Yes and No.

The "yes" applies to notification that the loan is in distress [illegible]

> "On determination...that a loan...is or has become a distressed loan the lender shall provide written notice to the borrower that the loan may be suitable for restructuring and include...copy of [restructuring] policy..."

This section applies to all loans, secured and unsecured.

The "no" applies to the 45 days. If we are not foreclosing but instead suing on the note, we do not have to wait the 45 days before suing on the note. The suit on the note may be brought immediately after the restructuring policy is received (3 days after mailing).

#23 Do we have to wait 45 days if we are going to receive a deed in lieu of foreclosure?

Deed in Lieu No - but the restructuring policy must be received by the borrower before the deed is received by the service center. In a separate writing, the borrower should acknowledge receiving a copy of the restructuring policy.

#24 How about the redemption period?

Redemption Period There will be no "rights" under the Act given during the redemption period.

Exception: In Wisconsin, the redemption period runs immediately after the judgment and expires upon or before the sale. Specific instructions will be given to Wisconsin service centers on how to handle this.

#25 What if we are suing for a deficiency?

Deficiencies A deficiency suit is not a foreclosure. Also the "loan" no longer exists. Since the Act only applies to loans, we don't have to wait 45 days.

#26
Waivers

Can the borrower waive any of the provisions of the Act? Waivers of the 45 days should only be used when the borrower genuinely has no interest in restructuring and wants the foreclosure process to move forward. Under no circumstances is a waiver to be included in a loan agreement for a new loan with a borrower or in a restructuring agreement.

Acceptable: a) Borrower with a distressed loan wishes to waive the 45 days.

Unacceptable: a) In a loan agreement for a new loan or other document signed at loan closing.

b) In a loan restructuring agreement. Because the new law requires restructuring if the cost of restructuring is less than the cost of foreclosure, it is our opinion that the waiver will not be upheld in court if the second restructuring is mandated by law. The borrower, therefore, gets a second 45 day notice.

c) As a threat or inducement to a borrower (e.g. you can keep the "back forty" if you waive your 45 day rights).

(Forms of waivers are attached to this memorandum.)

#27

Is there a distressed loan letter and a 45 day letter?

Distressed Loan Letter and 45 Day Letter

There could be. The distressed loan letter under 4.14A(b)(1) states that a notice must be sent to the borrower notifying him that his loan has become distressed. These will be used in bankruptcy cases (not Chapter 7). The 45 day notice section (4.14A(b)(2)), states that we shall notify the borrower that his loan may be suitable for restructuring and that FCS will not foreclose within 45 days of the borrower receiving the notice. They can be separate letters, but it should be very rare when we have a distressed loan with no intent to foreclose. In almost all cases (except bankruptcy), the distressed and 45 day letters should be combined.

If the loan becomes distressed and there is an intent to foreclose, the distressed loan notice and 45 day notice

will be combined into one notice.

#28 What if we send the 45 day letter but do not restructure or foreclose. Does the 45 day notice become stale?

Stale 45 Day Letter

Unlike the 14-30(17-33) day window we had under the regulations, the Act simply requires a minimum wait of 45 days; it does not place a "maximum" window on us. There is some concern, however, that a delay well beyond 45 days may make the original notice stale. We don't have a time (or want to create one) when we deem the letter stale. Each one should be looked at on a case-by-case basis. A rule of thumb would be if the borrower anticipates that we will not foreclose, another 45 day letter should be sent.

#29 What if there are several borrowers under one note but one or more of them will not cooperate (e.g. they do not send in supporting financial documentation with the "cooperative borrowers" request for restructuring)?

Several Borrowers

We can consider the application as being not complete and bring the foreclosure action on the 46th (49th) day. The ones that do cooperate are not entitled to initial review or a credit review as there is nothing to "review" if all required financial documents are not in. In other words, if all borrowers do not cooperate, there is no basis for review at all.

#30 Do we still notify borrowers about their §307 non-accrual status?

§307 Notices on Non-Accrual

No, it is our opinion that §307 has been replaced by §4.14D(d)(1) which states:

> "If a qualified lender places any loan in non-accrual status, the lender shall document such change of status and promptly notify the borrower in writing of such action and reasons therefor."

But 4.14D(d)(3) states that this notice requirement applies only if it results in an adverse action being taken against the borrower.

§307 did not have the "adverse action" language in it, but it is still felt that §4.14D(d) supersedes §307. However, §307 was not specifically repealed by the Act.

[redacted]

#31 **What is an adverse action?**

Adverse Action — We have defined "adverse action" as an action to collect the loan (accelerating, foreclosure) or a request for [redacted]

#32 **What about review of restructuring denials by the Special Asset Group (St. Paul) and the National Special Asset Council (Washington, D.C.)?**

Special Asset Group and National Special Asset Council — This review applies only if a district applies for and receives assistance from the Assistance Board (§4.14(C)). System attorneys have formed a sub-committee to review how this section will work.

#33 **How do we handle bankruptcies?**

Chapter 7 - No 45 Day Notice - This is a discharge of debt proceeding and results in no personal liability by the debtor to FCS. Accordingly, there is no debt to restructure.

Chapter 11, 12, 13

- Distressed Loan letter sent during bankruptcy.
- 45 Day letter sent after a bankruptcy dismissal or confirmation if he fails to meet plan

During Bankruptcy - In a Chapter 11, 12 or 13, the debt remains (unlike a Chapter 7) and the borrower is negotiating a deal with all of his creditors. It is deemed appropriate, therefore, to send him the Restructuring Policy without the 45 day requirement during bankrutpcy.

After Bankruptcy - If the bankruptcy action is dismissed, send the 45 day letter. If his plan is confirmed and he later fails to make payments under the plan, send the 45 day letter.

#34 The Act says we have to write off stock first when we forgive principal. Is accrued interest that has been capitalized considered principal forgiven?

Accrued Interest — No. If the interest can still be identified as "interest," it will not be considered principal If the records do not show it as interest anymore, we will have to consider it principal.

[redacted]

#35 Do we send a mailing to each borrower (e.g. husband and wife)?

Mailing Yes. However the mailing can be in one envelope so that [redacted] right of first refusal, the notice is in a separate envelope for each, sent by certified mail. [redacted]

#36 Can we charge a restructuring fee?

Restructuring Fee There is nothing in the Act which provides for or prohibits the charging of a fee to the borrower. The borrower must be restructured if the cost of restructuring is less than the cost of foreclosure. This means if a fee was imposed and the borrower refused to pay, you still have to restructure. It is being left to service center discretion.

#37 What form is used for credit investigation authorization as called for in Jim Cannon's letter of January 27th?

Request for Credit Information Form D2010.5 (order #14820) - Request for Credit Information. (Note: Where the form reads "I have applied for a loan" strike "a loan" and insert "restructuring" so it reads "I have applied for restructuring".)

Also add in the space next to the "Signature of Applicant" the following:

"This form may be photocopied and used for requests for information from other creditors."

RIGHT OF FIRST REFUSAL

#1 This really isn't a right of first refusal, is it?

Option Rather Than Right It's more like an option to buy. The previous owner has a right to buy the property as soon as we elect to sell and have an appraisal made of the property.

#2 Does it cover rural residence real estate?

Rural Residence No - only agricultural real estate is covered. It covers all property that we acquired either through foreclosure or deed in lieu of foreclosure. It would probably cover a farm residence located in the immediate proximity to any material portion of the farmer's production land.

#3 What does the law require?

Law - Summary It allows us to sell acquired property at a public offering (without an appraisal) or sell at private sale, in which case we must appraise the land and provide for the previous owner's notice of his right to buy. The notice to the

previous owner must be given within 15 days of our having the property appraised and our election to sell. Before we elect to sell, we must have the appraisal. Once we have the appraisal, our election to sell can come at any time but we should be consistent in choosing the date. Because of the inherent problems (and potential for lawsuits) in determining what is "first elects to sell", who is an accredited appraiser, and the previous owner's view on new higher appraisals, we are going to be selling most of our land using the public offering method which avoids all of these unknowns.

#4 — **What is the date FCS has determined as being the date we "first elect to sell?"**

First Elects To Sell - Definition

Because (1) we are in the selling season; (2) purchase offers are at their peak; (3) accredited appraisals are difficult to complete in a timely manner, we have revised the "first elect to sell" date from the acquisition date to the date we receive a purchase offer from a bona fide purchaser. When the selling season is over and we have in-house accredited appraisers, we may reassess this position.

#5 — **Why did we choose to give right of first refusal to property in inventory as of January 6, 1988?**

Acquired Property as of 1/6/88

It was more of a practical decision than a legal one. Legally, the Act has language and legislative history that implies the right of first refusal should be offered only to property acquired after January 6, 1988. However, potential lawsuits and title problems (if the title company or title attorney believes the right of first refusal should have been given, how do you argue with them?) prompted a retrospective application. Almost all of the other districts are also offering it for all agricultural properties in inventory which didn't have purchase agreements - for the same reasons: to reduce lawsuits and eliminate title problems upon sale.

#6 — **How does the mandatory v. permissive sale work?**

Mandatory and Permissive Sales

Putting it in the form of an example, it goes like this:

a) Property is appraised at $50,000.

FCS "first elects to sell."

Previous owner receives right of first refusal for $50,000 and told he may offer less than $50,000 but that any bid less than $50,000 may be rejected.

Previous owner offers $50,000. Under the mandatory sale FCS must sell it to him at that price (but it may

require payment in cash; FCS does not have to offer terms).

b) Suppose he offers $48,000.

FCS can choose to accept $48,000, or reject the $48,000.

If we reject, his bid goes into a "time-out" period. During that period, we can solicit other bids. If we receive one for $49,000, we can sell to the bona fide purchaser at $49,000 without going back to the previous owner.

c) If, however, we accept an offer for $48,000 or less, we must give the previous owner's "time-out" bid another chance and give him an opportunity to buy at $48,000 (assuming that was the highest bid). His "time-out" bid is now in play.

The tricky part is that the Act says that the property may not be sold "at a price equal to or less than that offered by the previous owner" or on different terms and conditions than those that were extended to the previous owner.

Before you ask, I will: "What does "different terms and conditions" mean? They aren't financing terms because we don't have to finance the previous owner. But what other terms and conditions (other than financing terms and conditions) would be different? One example would be taxes. We couldn't offer to pay all the 1988 taxes for the bona fide purchaser but in the offer to the previous owner we required him to pay the 1988 taxes. However, without financing, there are probably not many terms and conditions that are material which would vary from party to party.

#7 What are the timing intervals?

Timing Intervals

1) We have 15 days after we first elect to sell to notify the previous owner.

2) The previous owner has 15 days after receiving the notice to submit an offer.

3) For a mandatory sale, FCS must accept and sell the property within 30 days (of course, this means the previous owner must come up with the cash within 30 days if financing is not offered to him).

4) For a permissive sale, FCS must notify the previous

owner within 15 days after receipt of the offer (note: there is no requirement that the sale be completed within a certain number of days).

5) When (a) the previous owner's offer is "lower than appraisal" and is rejected, but then (b) a later acceptable offer from a purchaser is equal to or less than the previous owner's offer, and (c) the previous owner's bid is retrieved from its "time-out", then FCS must send the opportunity to purchase to the previous owner and he has 15 days to submit an offer to purchase the property at that price.

6) For mailing purposes, add 3 days to the above time intervals.

#8 **How about leasing?**

Leases

It works in a similar manner:

1) After the first election to lease, the previous owner is given an opportunity to lease at the "appraised rental value of the property" or offer to lease at a lesser rate.

2) FCS must send the notice within 15 days after having an "appraised rental value" and having "first elected to lease."

3) The previous owner must submit his offer to lease within 15 days. His lease can be for the amount of the "appraised rental value" or offer to lease at a lesser rate.

4) FCS must accept an offer at appraised rental value within 15 days after the receipt of the offer unless it is determined that:

   a) The previous owner does not have the resources to conduct a successful farming operation;

   OR

   b) The previous owner cannot meet all of the payment terms and conditions of the lease.

5) If his offer is less than appraised rental value, FCS may accept or reject the offer.

6) If FCS rejects and later accepts an offer equal to or

less than the previous owner's offer, it must give the previous owner an opportunity to lease at that price. After giving the notice by certified mail, the previous owner has 15 days after receipt in which to agree to the same rate offered by the bona fide lessee.

#9 — Do we still have the terms and conditions requirements?

Terms and Conditions — Yes. The best way to handle it is to make certain that the same terms and conditions are given to the bona fide lessee and the previous owner.

#10 — What is an "accredited" appraiser?

Accredited Appraiser — It can mean just about anything you want it to mean as long as it satisfies a judge. There is no statutory definition given for "accredited appraiser;" nor is it possible to find three people who will agree on a definition. It has never been used by Congress before so it has never come up before. FCS has defined it as follows:

> An "accredited appraiser" may be an independent contractor or a Farm Credit System employee who has demonstrated the ability to produce consistently reliable appraisals of agricultural real estate under criteria and standards established by a System institution.

Information will be furnished to you on how to handle this "accredited appraiser" issue.

#11 — What if we have a contract signed with a third party prior to January 6, 1988?

Pre-existing Contract for Sale — That contract should be honored. No right of first refusal should be given to the previous owner.

#12 — What if there are "writings" evidencing an agreement, but no purchase agreement was signed?

"Writings" Arising to Level of Purchase Agreement — These will have to be examined by an attorney. It depends on whether the "writings" rise to the level of a purchase agreement and would be binding on the parties without further agreement.

#13 — May the borrower waive the right of first refusal?

Waiver — The Act doesn't indicate one way or the other, but since it was based on Minnesota law and Minnesota law allows

waivers in a deed in lieu of foreclosure, we are of the opinion there is no problem with having it done on deeds in lieu under the Federal law also. Any other form of waiver is not advised. This applies only to future deeds in lieu.

#14 How about title problems? How does the bona fide purchaser know if the previous owner received the right of first refusal?

Title Problems Minnesota had this problem for a year and then in 1987 the legislature proposed an affidavit for the seller to record evidencing that the right had been given. The federal law does not provide for affidavits or any other title assurance. The legislative history simply states that there was no intent to affect title by creating a right of first refusal. We are recommending the attached affidavit (page 53A) be used in all states. A form of waiver is found on page 53.

#15 What if the acquired property is 500 acres, the previous owner does not offer on his right of first refusal, and later we sell off 100 acres of the property?

Sales of Portions of Acquired Property He is entitled to his right of first refusal on the 100 acres. Any land offered that is less than the first offer must be considered a different sale and the right given one more time.

#16 How are we going to handle public offerings?

Public Offerings The Acquired Property Department sent out a memo on this.

#17 Who is a "previous owner?"

Previous Owner It would appear from the language in the Conference Report that the Conference Committee equated "the person from whom the FCS institution acquired title" with the previous owner. This leads to the conclusion that the previous owner is the borrower who was personally liable on the debt and had an interest in the agricultural real estate immediately prior to acquisition of title by FCS.

#18 What if there are multiple "previous owners?"

Multiple Previous Owner Send a separate notice by certified mail to each previous owner.

#19 — Is it necessary to add days for delivery in addition to the 15 day notice?

Three Days for Delivery — The notice must be sent by certified mail and he has 15 days from the date of receipt to accept. Therefore, check the return receipt and add 15 days to it to determine the proper time period. You may wish to send by first class mail also to further establish delivery of the notice.

#19A — How about receiving delivery back from the previous owner when he elects to repurchase the property?

In this case we must add 3 days. The Act says "the previous owner has 15 days after receiving the notice to submit an offer. "Submit" is a term that could be interpreted by a court as sending within 15 days, or being received within 15 days. The conservative approach therefore is to take the former interpretation and allow them 15 days to send the offer. This means adding 3 days for delivery. Accordingly, do not close to the third party purchaser until day 19.

#20 — What if the previous owner is in bankruptcy?

Bankruptcy — Send the notice to the previous owner, his attorney, and the trustee, if one is appointed.

#21 — In Minnesota, can the Minnesota and Federal Right of First Refusal run simultaneously?

Minnesota Right of First Refusal — Yes, if the events triggering each event occur during the same time period. For example, if a bona fide purchaser submits an offer and that is the day we elect to sell, we can send the purchase agreement(Minnesota) and the appraised value (Federal) on the same day. The 15 and 65 days will run simultaneously.

#22 — We understand that if a purchase agreement was entered into before January 6, 1988 with a bona fide purchaser, the right of first refusal does not have to be given to the previous owner. But what if the bona fide purchaser (his attorney or title company) insists that the right of first refusal be given even if not required?

Bona Fide Purchaser Requests Right of First Refusal Be Given — While not required, if the purchaser insists on it there is no reason to object. Make certain the purchase agreement is amended to reflect that the purchaser required that the previous owner receive the right of first refusal.

#23 — Who is a notice given to in the case of an estate?

The notice should be sent to the personal representative, executor, administratrix, etc.

EXAMPLES OF "45 DAYS" UNDER RESTRUCTURING STATUTE

Borrower Status	Distressed loan
Action	Restructure policy and notice sent on Day 1.
Example 1:	
Response	No response by borrower.
Result	Foreclosure commenced on Day 49 (46 + 3 days for mailing) or later. The commencement of foreclosure is deemed to be the publication or summons and complaint. It is not the acceleration letter.
Example 2:	
Response	Response on Day 8. Denial on Day 15. Credit review requested on Day 22. Credit review upholds denial on Day 30. Even though all the required restructuring actions have been completed, the earliest foreclosure can commence is Day 49.
Example 3:	
Response	Response received on Day 49.
Result	If restructuring is still the correct business decision, then restructure, however, borrower has lost all Federal rights, and if restructuring is not feasible, foreclose on the collateral.
Example 4:	
Response	Response received on Day 48 without supporting schedules (tax returns, financial statements, etc.).
Result	This is a difficult case. If his inadequate response was given on Day 20, we would have given him additional time to get the supporting materials in. His very late inadequate response is an obvious effort to buy time. This is, however, another "tie" and we will give him a few days to get the materials in. His time for initial review can be accelerated, but he will still have full credit review rights.

Example 5:
Response — Request and material received on Day 45. Meeting requested for Day 70 (he's busy planting).

Result — The request for meeting is unreasonable. FCS can set an earlier date (one week notice is sufficient). If he fails to attend, he has lost his meeting rights. However, he still has to be given a meaningful review of his plan with appropriate analysis.

Example 6:
Response — Same as 5 with credit review requested on Day 70 (20 days after denial). Again, an unreasonable request. We can set credit review for a week after his request. (He has 7 days after receiving a denial to request one.)

On February 4, 1988 in approximately

Farm Credit Services

375 Jackson Street
P.O. Box 64949
St. Paul, Minnesota 55164-0949
612/221-8600

DATE: February 4, 1988

TO: All FCS Service Center CEOs

FROM: Philip L. Erickson, Managing Attorney-Credit & Operations

SUBJECT: Waiver of Restructuring

Attached is a form of waiver of restructuring under §4.14A of the Farm Credit Act. The instructions for use of this form are as follows:

1. It is to be used only when the borrower wants to waive the 45 days. These cases will arise (1) when foreclosure is necessary to eliminate secondary liens and this benefits the borrower, (2) we have reached some understanding with the borrower and a 45 day wait makes no sense, or (3) the borrower simply wants to "move on" to something else and does not want to bear the expense (interest, taxes, lost opportunity) inherent in waiting 45 days for the process to end.

2. Under no circumstances is it to be used as an FCS negotiating tool to accomplish a given result. It is used only when it is in the best interest of the borrower to do so.

3. Make certain a copy of §4.14A is attached to the waiver.

4. The borrower is to be given an opportunity to have the waiver reviewed by his attorney. Accordingly, never have him sign on the same day he receives it. Insist that it be signed the following day at the earliest and advise him to seek legal advice.

/le
enclosures

cc: W. Collins
R. Johns
J. Cannon
D. Theuninck
G. Flemming
P. Kramp
G. Elwood
D. Kettering
G. Foss
B. Lasure
D. Swaden
T. Baruth

TABLE OF DAYS

	TIME REQUIRED	ADDED DAYS FOR MAIL DELIVERY	TOTAL	KEY WORD IN ACT WHICH REQUIRES ADDITIONAL TIME DELAY
Send Restructuring Policy	n/a	n/a	n/a	n/a
Days FCS must wait to receive restructuring application before foreclosing	45	3	48	none, FCS position to wait 3 days
Days borrower has after receiving denial of restructuring to request credit review	7	0	7	"requests" - Borrower requests credit review - request means receipt of request
Days applicant has to request credit review after denial or reduction of loan application	30	0	30	same as above
Days FCS has to notify previous owner of right of first refusal after first electing to sell	15	0	15	"notify" - FCS must notify previous owner within 15 days after first electing to sell - notification is by deposit in U.S. mail
Days previous owner has to submit offer on right of first refusal after receiving notice from FCS	15	3	18	"submit" - Previous owner has 15 days after receiving notice to submit offer - "submit" can mean "send" or "receive." - safer to add 3 days
Days after receipt of offer to buy at appraised value (by previous owner) FCS has to accept and close on previous owner's offer	30	0	30	"receipt" - FCS shall, within 30 days after receipt of offer, accept and sell.
Days after receipt of offer FCS has to accept or reject offer to buy at less than appraised value.	15	0	0	"receipt" and "notice" - FCS shall notify previous owner of acceptance or rejection of offer within 15 days after receipt of offer. Notification is by deposit in U.S. mail.

February 1, 1988

TO: All FCS Service Center CEOs
All FCS Service Center Directors/Managers of Acquired Property
Jim Cannon, Senior Vice President, Appraisal, Credit Policy and Review
Area Appraisal Managers

FROM: Layton C. Hoysler, District Director, Acquired Property
Robert M. Boeve, District Manager, Acquired Property
Phil Erickson, Managing Attorney, Credit and Operations

SUBJECT: RIGHTS OF FIRST REFUSAL

Many of you have been eagerly awaiting direction on how to proceed with handling the Federal law regarding rights of first refusal for previous owners. The district has decided to use public, competitive bidding for dealing with this law in most cases. However, many purchase offers have been accepted since January 6, 1988, and we need to begin complying with the Federal law on these purchase offers per number 1 below. For the interim period, until we come out with definitive methodology for handling competitive bidding, please use number 1 below:

1. If the sale cannot be handled through the public offering process (e.g., purchase offers which have already been accepted), order a new appraisal from your appropriate area or state appraiser explaining that the requested appraisal will be used to satisfy the right of first refusal. Along with the request for a new appraisal, acquired property personnel must furnish the area appraiser all of the details on the property pertinent to the appraisal process. If an acceptable purchase offer has been received, include details of purchase price, terms, contingencies and previous owner contractual obligations. The area appraiser will conduct a new appraisal considering the acceptable purchase offer along with all other available market data. The appraisal will be reviewed by an ARA or MAI employed by or under contract to FCS. After the appraisal is completed and reviewed the previous owner must be notified of his 15-day right of first refusal opportunity at the appraised value. This process will take time to accomplish, thus it is advantageous to use the public offering approach whenever possible.

RECEIVED
FEB 4 1989
Incoming Mail

2. If an accepted offer to purchase is less than the appraised value, the previous owner should be notified that the property is available at the accepted offer price and that the 15-day right of first refusal ends on a specified date. Previous owner should also be notified of our appraised value of the property. A copy of the purchase agreement (with the name of the third-party purchaser deleted ["whited out"]) should be furnished to the previous owner along with the certified mail notice of right of first refusal. (See attached recommended letter to previous owner.)

3. If, in your judgment, an outside appraisal by an accredited appraiser appears necessary and warranted because of a potential for the value to be contested, please call FCS, St. Paul, acquired property department for direction.

4. After FCS, St. Paul, develops procedures and methodology, wherever possible, use the public offering process allowed under the Federal law. This will substantially reduce the time needed to close our sales and generally result in a higher sale price. We will be forwarding methodology for this in the near future.

5. On offers to purchase following receipt of this directive, be certain to notify the prospective buyer in writing as a part of the purchase agreement, that the sale is subject to the right of first refusal by the previous owner and that the property may be offered to the public by sealed bids.

We wish to encourage you to continue accepting purchase offers and making sure purchasers are aware that this property is subject to rights of first refusal.

EXERCISING RENTAL RIGHTS OF FIRST REFUSAL

The Act uses the language, "when a system institution first elects to rent."

We recommend:

1. Where a property was leased in 1987 to a tenant who has a signed lease for 1988 executed before January 6, 1988, that no right of first refusal be offered to the previous owner.

2. Where a property was leased in 1987 to a tenant who requested continued lease opportunity for 1988, that no right of first refusal be offered the previous owner. Intention to lease may be assumed by requests to proceed with fall plowing, ordering of seed and supplies or other acts indicating future plans.

3. Where property was not leased in 1987 or where the 1987 lessee is not scheduled to operate the farm in 1988, an executed lease to a new lessee dated prior to January 6, 1988, shall preclude the need to offer right of first refusal to the previous owner.

4. Where there was no existing lease as of January 6, 1988, or intention to lease to the 1987 lessee, right of first refusal to lease shall be extended to the previous owner.

   A. We recommend advertising the availability of the property in local newspapers with interested parties submitting sealed bids by a certain date.

   B. Certified mail notice should be extended to the previous owner of the public offering where he may submit a bid with a certified check for 10% as evidence of his intention to lease. If the previous owner is required to pay cash, an appropriate discount should be provided unless cash is required from all bidders.

   C. Previous owner should be offered the right to equal the highest bid received.

   D. The choice of whether to use absolute sealed bids or sealed bids with rights to raise is a local decision as long as it is advertised and publicized prior to opening of the bids.

SAME TERMS AND CONDITIONS

The law emphatically states that we must offer the previous owners the same terms and conditions of sale or rental that we offer to any other person. However, we are not required to extend financing to former owners. Therefore, when you prorate taxes, extend the guarantee, escrow funds for improvements, set closing dates, or make other provisions that do not involve the extension of credit, you must extend these same terms and provisions to the previous owners by certified mail. This mailing must be sent to their last known address. If you have knowledge of their current address, you should make certain you use it. Where mailings come back unopened, or undeliverable, etc., we are suggesting that you file them without opening the envelope. The former owner has 15 days from receipt of our notice to submit an offer on properties where a current appraisal by an accredited appraiser is utilized. If you do not receive an offer from them within 15 days, on the 16th day you are free to sell the property to your bona fide purchaser. Should an offer be delivered by the previous owner within 15 days of receipt of our notice, you can demand that they provide cash to close within 30 days of notice. Should he be unable to perform, you should notify him that you intend to sell the property to your bona fide purchaser. If you demand that they close within 30 days, you should do so in writing by certified mail. Furthermore, you must be able to deliver clear title and all other terms which were extended at the date of closing.

Finally, if possible, do not notify the bona fide purchaser that their deal has fallen through until after the previous owner has successfully purchased and closed their right of first refusal. We may find that some owners notify us of their intent to close but will be unable to consummate the closing.

CONCLUSION

There are many unresolved questions and issues that this communication does not address. The FCS, St. Paul, acquired property and legal staff will be coming out with further communication that is more detailed and will particularly address the methodology of public, competitive bidding procedures. In the interim, please use appraisals done by ARAs or MAIs per discussion above. The decision whether to extend financing to previous owners should be made at the local level. If you have any questions or comments, please don't hesitate to call.

Attachment

ATTACHMENT

```
************************************
Note to Service Centers:           *
                                   *
Mark the envelope "Right of First  *
Refusal Notice".                   *
************************************
```

SENT BY CERTIFIED MAIL

Re: Right of First Refusal

Dear [previous owner]:

The Federal Land Bank of Saint Paul has elected to sell property [description attached] which you previously owned. Under the Agricultural Credit Act of 1987 (the "Act"), you are given a right of first refusal to repurchase this property.

You may purchase the property at the appraised fair market value which is $_____.

Your rights to purchase the property are as follows:

Mandatory Sale:

1. You have the absolute right to purchase the property for $_____.

2. If you wish to purchase it at this price, you must make an offer to purchase within 15 days after you receive this letter. If you make an offer, we recommend either delivering it personally to our office with receipt requested or mailing it certified mail to the above address. Under the Act, it is important that you establish delivery or mailing within 15 days of receiving our certified letter.

3. If you offer to buy at $_____, the Act says we must accept your offer and do so by accepting and selling within 30 days of receiving your offer.

4. Option A: We are offering you financing terms which are included in the attached agreement.

   Option B: If you wish to purchase the property, the terms are "cash" and the sale must be closed within 30 days of the day we receive your offer. In other words, you must have your financing arranged with another lender and have the full payment price of $_____ in the form of a cashier's or certified check at the closing, which will take place no later than 30 days after we receive your offer.

Permissive Sale

1. If you do not wish to purchase the property at the appraised value of $_____, you may offer to purchase the property at a price less than $_____.

2. Your offer to purchase at less than $_____ must be submitted within 15 days after you receive this letter.

3. If your offer is less than $_____, the Act says we may either accept or reject your offer.

   a) If we accept, we will close at a reasonable, mutually agreeable time.

   b) If we reject your offer, we will notify you within 15 days of receiving your offer.

      i. If your offer is rejected, we will "hold it" pending receipt of other offers.

      ii. If another offer is received that is higher than yours, the property will be sold to that person without further notice to you.

      iii. If we accept an offer from another person at a price equal to or less than your offer, we will come back to you again with another opportunity to purchase the property. The terms and conditions to you will be the same as offered to the other person. Financing is not a "term or condition" under the Act, and we may offer financing to other parties without offering it to you. This opportunity to purchase works as follows:

         aa) You may resubmit an offer at the same price and same terms and conditions as offered to the third party. (Again, financing is not a "term or condition" that has to be the same for you and the other person. We can finance the third party but refuse to finance you.)

         bb) If you do submit such an offer, we must accept it. If we accept it, we are not obligated to offer you financing and may insist on cash at the closing.

Failure to Respond

If we do not receive an offer in writing from you (either at appraised value or less) within 15 days from the day you receive this letter, you lose your right of first refusal and we may sell the property to any person at any time without further notice given to you.

This is an important right and we encourage you to consult with an attorney if you wish to exercise it before the 15 days expire.

Very truly yours,

[redacted]

```
************************************
Note to Service Centers:           *
                                   *
Mark the envelope "Right of First  *
Refusal Notice".                   *
************************************
```

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Mandatory Sale:

1. You have the absolute right to purchase the property for $_____.

2. If you wish to purchase it at this price, you must make an offer to purchase within 15 days after you receive this letter. If you make an offer, we recommend either delivering it personally to our office with receipt requested or mailing it certified mail to the above address. Under the Act, it is important that you establish delivery or mailing within 15 days of receiving our certified letter.

3. If you offer to buy at $_____, the Act says we must accept your offer and do so by accepting and selling within 30 days of receiving your offer.

4. Option A: We are offering you financing terms which are included in the attached agreement.

   Option B: If you wish to purchase the property, the terms are "cash" and the sale must be closed within 30 days of the day we receive your offer. In other words, you must have your financing arranged with another lender and have the full payment price of $_____ in the form of a cashier's or certified check at the closing, which will take place no later than 30 days after we receive your offer.

Permissive Sale

1. If you do not wish to purchase the property at the appraised value of $_____, you may offer to purchase the property at a price less than $_____.

2. Your offer to purchase at less than $_____ must be submitted within 15 days after you receive this letter.

3. If your offer is less than $_____, the Act says we may either accept or reject your offer.

   a) If we accept, we will close at a reasonable, mutually agreeable time.

   b) If we reject your offer, we will notify you within 15 days of receiving your offer.

      i. If your offer is rejected, we will "hold it" pending receipt of other offers.

      ii. If another offer is received that is higher than yours, the property will be sold to that person without further notice to you.

      iii. If we accept an offer from another person at a price equal to or less than you offered, we will come back to you again with another opportunity to purchase the property. The terms and conditions to you will be the same as offered to the other person. Financing is not a "term or condition" under the Act, and we may offer financing to other parties without offering it to you. This opportunity to purchase works as follows:

         aa) You may resubmit an offer at the same price and same terms and conditions as offered to the third party. (Again, financing is not a "term or condition" that has to be the same for you and the other person. We can finance the third party but refuse to finance you.)

         bb) If you do submit such an offer, we must accept it. If we accept it, we are not obligated to offer you financing and may insist on cash at the closing.

         cc) If you (1) submit an offer, (2) we accept it, (3) you do not have the cash to close within 30 days but (4) we are prepared to clsoe by giving you marketable title, then you may forfeit your earnest money and we do not have to offer you the right of first arefusal again on this property.

Failure to Respond

If we do not receive an offer in writing from you (either at appraised value or less) within 15 days from the day you receive this letter, you lose your right of first refusal and we may sell the property to any person at any time without further notice given to you under the Act.

This is an important right and we encourage you to consult with an attorney if you wish to exercise it before the 15 days expire.

Very truly yours,

JOHN MELCHER, MONTANA
DAVID H. PRYOR, ARKANSAS
DAVID L. BOREN, OKLAHOMA
HOWELL HEFLIN, ALABAMA
TOM HARKIN, IOWA
KENT CONRAD, NORTH DAKOTA
WYCHE FOWLER, JR., GEORGIA
THOMAS A. DASCHLE, SOUTH DAKOTA
JOHN B. breaux, LOUISIANA

RICHARD G. LUGAR, INDIANA
ROBERT DOLE, KANSAS
JESSE HELMS, NORTH CAROLINA
THAD COCHRAN, MISSISSIPPI
RUDY BOSCHWITZ, MINNESOTA
MITCH McCONNELL, KENTUCKY
CHRISTOPHER S. "KIT" BOND, MISSOURI
PETE WILSON, CALIFORNIA
DAVID K. KARNES, NEBRASKA

United States Senate

COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

July 12, 1988

Mr. Jim Massey
Farmers Legal Action Group
1301 Minnesota Building
46 East 4th Street
St. Paul, Minnesota 55101

Dear Mr. Massey:

We appreciate your testifying before the Committee on June 16, 1988. Enclosed are additional questions which are being submitted to you for written answers. We would appreciate receiving your answers to the questions by July 29, 1988 so that the hearing record may be printed as soon as possible.

Thank you for your cooperation.

Sincerely,

DAVID L. BOREN
Chairman
Subcommittee on
Agricultural Credit

Questions from Senator Tom Daschle
Hearing on the Implementation of the Agricultural Credit Act of 1987
Senate Agriculture Committee
June 16, 1988

JIM MASSEY

In your testimony you mentioned that there are not guidelines for independent appraisals issued through FCA. What sort of problems do you anticipate for borrowers and do you feel that they have been adequately notified of their options if their loan becomes distressed?

In your testimony you mention that information about the cost of restructuring is not available to the borrower while trying to work out a deal with the FCS. What are the implications nationwide by this decision, and is there anything that you would suggest to FCA to correct this situation?

FARMERS' LEGAL ACTION GROUP, INC.

360 Southwest Cascade Street
P.O. Box 1689
Sisters, Oregon 97759
(503) 549-0533
FAX: (503) 549-0171

September 23, 1988

Honorable David L. Boren, Chairman
Sub-Committee on Agricultural Credit
Committee on Agriculture, Nutrition
and Forestry
U.S. Senate
328 A Russell Office Building
Washington, D.C. 20410-6000

Dear Senator Boren:

Thank you for the committee's invitation to testify on behalf of our clients on June 16, 1988. I am writing now in response to the additional questions from Senator Daschle, which were forwarded to me with your letter of July 12, 1988.

For the committee's information, I enclose a copy of the comments submitted by my organization to the Farm Credit Administration (FCA) June 10, 1988. These comments address the proposed rule published by the FCA May 12, 1988 at 53 Federal Register 16937, and form the basis of the testimony I gave June 16.

APPRAISAL PROBLEMS
Senator Daschle's first question relates to the absence of any FCA guidelines for carrying out the "independent appraisal" provisions of the Agricultural Credit Act of 1987. I noted in my testimony before the committee that none existed and suggested that problems would result.

The Senator also asks if borrowers are adequately advised of their right to seek an independent appraisal. They are not.

Senator Boren
September 23, 1988
Page 2

As we point out in our comments on pages 5 and 6, the absence of FCA guidelines leaves FCS institutions free to determine for themselves the qualifications necessary for designation as an "accredited appraiser," and to develop a list of three such appraisers from whom the borrower may choose to obtain an "independent" appraisal. To highlight the nature of the problem, we note in our comments the St. Paul district policy, which states that an accredited appraiser "...could mean just about anything you want it to mean as long as it satisfies a judge." The St. Paul policy goes on to indicate that FCS contractors and employees with histories of "reliable" appraisals satisfy the "accredited" standard.

As I am sure the committee knows from its own experience, appraisals, and appraising, can be very slippery business, particularly in a real estate market that is unusually volatile or depressed. Appraisers frequently disagree substantially, and, unfortunately but true, their perspective is often guided by whoever is signing their check. Congress' recognition of this is implicit in the statutory requirement relating to independent appraisals. Thus, if an FCS borrower may only choose an "accredited appraiser" from a list established by the FCS, a list which may be composed of its own employees or contractors, one must surely question the appraiser's "independence."

The problems this may create go to the heart of the two most significant borrower's rights provisions contained in the Agricultural Credit Act of 1987--loan restructuring and right of first refusal.

RESTRUCTURING

An accurate appraisal is the starting point of most restructuring considerations. Since only a "distressed loan" is eligible for restructuring, one that cannot cash-flow, which is undersecured, or both, many restructuring plans will work only if principal and past due interest are "written-off" by the lender. Because the Act, and sound business practice, mandate that such a write-off not fall below the recovery value level, it is absolutely crucial out of fairness to the borrower and prudence to the lender that the best possible appraisal be had.

If the proposal is too high--a possible result of an enthusiastic FCS staff or contract appraiser who may see a gain in liquidating the loan, the borrower will be denied that to which he or she is entitled under the Act.

If the proposal is too low, and the loan is restructured, the bank will lose what it should not in the case of a farmer with no additional assets. Or, where additional assets are available, the bank may demand more security, or require its liquidation, than it should be allowed to under the Act.

In either case, because the individual borrower's and the bank's direct financial interests are at stake in any restructuring negotiation, every dollar of an inaccurate appraisal is a windfall to one party and a taking from the other.

FIRST REFUSAL
Under the Act, former owners of FCS acquired real estate are entitled to repurchase that real estate at its appraised fair market value. If the "accredited" appraiser used by the bank is not completely neutral or independent, either the bank or the borrower may lose. If the appraisal is set artificially high, the borrower may be unable to exercise his or her right and lose the farm to a speculator, or perhaps to a neighbor willing to pay a strategic "premium" for that particular piece of property. This is not at all what Congress appears to have intended with the 1987 Act. Obviously, if an appraisal were set too low, the bank would not recapture what it should.

Unfortunately, FCA has declined to remedy these problems in its recently published regulations. 53 Federal Register 35427 (September 14, 1988). FCA does suggest in these regulations that it will address the issue at some later date, but it does not indicate how or when. 53 Federal Register 35438.

NOTICE PROBLEMS
In addition, FCS borrowers have not even been adequately informed of their right to seek an independent appraisal. Although FCA claims in its prefatory comments to 12 C.F.R. Sec. 614.441, published September 14, 1988, that it now requires such a notice, the language in the new regulation is neither precise or forceful enough to compel banks hostile to this concept to provide adequate information. If the borrower does not know he or she may seek an independent appraisal, even the presence of truly independent appraisers will not address the goal sought by Congress.

INSUFFICIENT RESTRUCTURING INFORMATION
Senator Daschle's second question relates to my comments regarding information that is not provided to borrowers during the restructuring application process. He inquires what the nation-wide implications are of this problem, and how FCA might correct it.

Again, I direct the committee's attention to the enclosed comments on 12 C.F.R. Sec. 614.440 and 614.4516. As noted, FCS lenders refuse to provide to borrowers at the restructuring application stage the lender's calculation formula and figures for cost of restructuring and foreclosure. Thus, the borrower must prepare an application "in the dark" about these figures and how they will be determined. Without this information, particularly the lender's calculations of foregone principal and interest on the one hand, and projected recover costs on the other, the borrower can only guess.

The notice of restructuring and application requirements are also inadequate to insure that the borrower will know what must be submitted with the application. Although references made in the statute to a "preliminary plan" of restructuring, the borrower must submit a "complete application" without a specific listing of what is required of the borrower, and how the "preliminary plan" will be treated in the application process. Again, borrowers are left to guess at what is required of them.

Senator Boren
September 23, 1988
Page 5

To compound this problem, FCS lenders are treating the application for restructuring as a "one-shot" process, and do not allow amendment or enter into subsequent negotiations with the borrower over the "preliminary plan." This practice is clearly contrary to both the language and the intent of the statute. In addition, if the lender discloses its information on costs and calculations at all, it is only after the denial of the borrower's application, apparently for use by the borrower before the Review Committee. This approach, of withholding information on the one hand and at the same time prohibiting amendment and refusing subsequent negotiations on the other, is absolutely contrary to the spirit and apparent literal meaning of the Act. Moreover, it flies in the face of generally accepted commercial practice in the area of loan negotiations and workouts.

We address our recommendations to FCA in the comments on page five. In short, we recommend an open process that assumes mutual disclosure, on-going negotiations, and flexibility in development of the plan for restructuring. We also request that the borrower be provided with a complete and detailed list of all of the documents and other information the borrower must provide to satisfy the "complete" application requirement.

Although it expresses some sensitivity to these problems, in its prefatory comments to the new regulations, FCA has again declined in the actual regulations themselves to remedy them.

In its prefatory comments to 12 C.F.R. Sec. 614.4440 (c), FCA expressly declines to require more specificity in the notice provided to borrowers with the application for loan restructuring. Moreover, FCA also refuses to require FCS lenders to disclose their calculated costs of foreclosure and restructuring during the application process. Finally, while FCA does pay lip-service to the problem of a "one-shot" approach to review of the borrower's application for restructuring, it only complicates the issue with its comments. FCA, on the one hand, does indicate that a preliminary plan should be just that, and that a lender should not summarily reject it. On the other hand, it indicates at the same time that a borrower should not be allowed to "continually amend his plan." As a bottom line, FCA indicates that the application stage should be governed by a "reasonableness standard" and that both parties "must put forth a good-faith effort and work together."

Senator Daschle asked what the nation-wide implications are of these problems. In short, these implications are that the restructuring process will be one-sided, unfair and commercially unsound. In these times of hard ground and harder feelings, "good-faith," "reasonableness" and the like are noble goals but unrealistic standards. Farmers are desperately trying to hold onto their homes, livelihoods and heritage. FCS lenders are trying to bring up their bottom lines, and quickly. The process needs FCA guidelines that are concrete, articulable and enforceable, not flaccid or fantasy-like standards which work only in the best of normal circumstances. The restructuring process being used by FCS lenders, and recently given the stamp of approval by FCA, will not produce commercially sound outcomes. It is guaranteed to exacerbate hard feelings, alienation and distrust being felt and expressed by FCS borrowers across the country.

We appreciate this opportunity to submit these additional comments. We will be preparing a comprehensive analysis and comments on the FCA regulations in the next several weeks. We would be happpy to forward those to the committee when they are complete.

We thank the committee again for its interest in our clients' concerns.

Sincerely,

James T. Massey

James T. Massey
Executive Director

Senator BOREN. Thank you very much. I look forward to looking at that analysis of the way the formula works.

Mr. MASSEY. Just one last thing, I apologize. We have deleted from our comments to the Farm Credit Administration a very lengthy handbook from St. Paul. I deleted it from the 75 copies submitted, but if the committee has not seen the St. Paul handbook, which consists of some 40 or 50 pages, I think it is a critical document to have a closer view of what is happening, at least in the St. Paul District, as descriptive of some of the things I have talked about, particularly the calculations and formulas, and I would be happy to forward a copy to the chairman for the subcommittee's use.

Senator BOREN. Thank you very much.

Mr. Glenn, it is certainly good to have you with us today and we welcome any comments that you have.

STATEMENT OF MAX E. GLENN, EXECUTIVE DIRECTOR, OKLAHOMA CONFERENCE OF CHURCHES, OKLAHOMA CITY, OK

Mr. GLENN. Thank you, Mr. Chairman. I appreciate the serious work that this subcommittee has done, and you personally. It has been a pleasure to share with Oklahomans the hard work that their Representatives have done and the very careful work it is my privilege to personally observe, to assess and to follow very carefully the enactment of this legislation.

I concur with what Mr. Massey has just shared, of my deep concern for the lack of carrying out the intent of the law. In fact, it occurs to me as I sat here that if as much money and energy were spent in developing a win-win situation for rural America and for family farmers as is being spent on how to avoid this law, as I personally stood in the Cherokee County courthouse a year ago and the home place I was raised on was sold by my best friend in high school, Sam Otis, the Sheriff, and the Farm Credit System attorney said I am going to announce before the sheriff begins that these two farms have $50,000 legal fees in. Now, that is as ridiculous in my mind as the antiques and the rugs, because I think a great deal can be saved, so I would encourage that.

Let me just lift up real quickly a few points that I think have not been focused on as clearly. First of all, out of all of our work and over 30,000 calls from a hotline, we have submitted comments about the Farm Credit System procedures and actions. The FCS is proceeding with collection actions, foreclosures and foreclosure proceedings, while Farm Credit Administration regulations are pending.

Our understanding of the act clearly states that this cannot be done. I would particularly call to your attention the language of the 45-day letter which is sent to Farm Credit System borrowers. It has been very skillfully crafted, but the hundreds and thousands of farmers that we talk to do not really understand the intent of that letter, and it is attached with our attachments. It is very vague, it is extremely subject to misunderstanding, and frankly it is quite disturbing by what it does not say.

This letter is supposed to be a notification to inform the borrower, also a Farm Credit System stockholder, that the lender has de-

termined that the loan is or has become a distressed loan. However, the letter does not even contain the word "notification," and I submit to you that this letter is not clear, it is not an attempt to be open and up-front with the farmer, borrower, stockholder. I would invite you to look into that.

A second area of concern that I would lift up is the increased activity and intensity, and I believe these are indicators of the Farm Credit System actions. The Oklahoma Ag Link Telephone Hotline activities have seen a significant increase. In 32 months, we have processed over 30,000 calls. In May of this year——

Senator BOREN. Say that again.

Mr. GLENN. Over 30,000 calls from Oklahoma farmers and ranchers have been processed in 32 months. Calls received in May of 1988, last month, were increased by 47 percent over April, the preceding month, and 78.5 percent of the calls received pertained to Farm Credit System situations.

Furthermore, the critical nature and the intensity of the calls are alarmingly increased. These telephone calls from farmers who are Farm Credit System borrowers are directly related to the topics that we have been discussing today. It is also important to——

Senator BOREN. What are the most common problems, the problem of getting their calculations, for example, or something else?

Mr. GLENN. Getting the calculations, not understanding what is in that 45-day letter, the fear. I understand, and we have developed a good relationship with the district officials, I understand that many people are not picking up the certified letters. The farmers are scared, and so we are really not communicating with them.

Then you get a letter, as I do. We get many, many horror stories that we could sit here and swap back and forth. But the facts are that the letter and intent of the law simply is not being followed. I was horrified to find that a major section of the act, which provides for mediation, and Congress did not even provide funding, appropriations for that. It is working in Oklahoma, but it is working reluctantly.

I had a visit yesterday morning from Mr. Earl Hall, vice president from Wichita, Oklahoma, and he wanted us to do mediation after the restructure effort and the denial and after the appeal and then do mediation as a last resort. Two weeks earlier he had visited with us and said can we do mediation up front, we want to do it as soon as possible, we would like to do mediation as part of that 45-day process. So we see mediation as a process to assist in the restructuring, not a case afterwards, and so that is an area that is really of concern to us.

Senator BOREN. I am sorry that we did not. You know, we put the funds in on the Senate side, but we did not get them on the House side up to this point, but we are still working on it.

Mr. GLENN. I understand that is still going on.

We have a 76 percent settlement rate in the mediations between farmers and creditors. The human costs is another area that really needs to be lifted up. In Oklahoma, there are reportedly 1,380 Farm Credit System distressed loan customer farmers. Our information indicates that approximately 877 of those customers have received a 45-day notice. This indicates the intent of the Farm Credit System to liquidate 877 businesses or farmers within a rela-

tively short period of time, even before the regs are in place. This intent presents two disturbing possibilities to me.

One, the elimination of 877 businesses is a tremendous economic and social impact within our State. If there was an announcement in any of our newspapers that 877 businesses were leaving the State of Oklahoma within the next 6 months, I daresay that all the media, all the governmental units, the school districts, the churches, the Chambers of Commerce offices would take notice and be moved to action.

Second, the elimination of 877 farmers' businesses does directly and immediately affect the small rural business community in a ripple effect and impacts the urban areas.

In summary, I would say that in my judgment the Federal Government has very adequately protected the rights and the borrowers who are customers of commercial banks and savings and loan associations. You have very wisely established regulation procedures and so on.

We are, however, shocked and disgusted at the apparent attitude of the Farm Credit System to place itself above the law, above your directives in the Farm Credit Act. We have good news and bad news.

Senator BOREN. Yes.

Mr. GLENN. The good news is the Farm Credit officials from Oklahoma participated with us in doing workshops across the State. We were real excited, there was a new hope generated in Oklahoma. Now that hope has diminished and we are deeply distressed.

I lift up for you finally, Mr. Chairman, our concern as we continue to monitor the growing sense of anger, outrage, betrayal and violence. In my testimony before the full Senate Ag Committee a year ago, I shared some of that information. I can submit to you now, we had a preliminary reprieve because of the hope for this act.

We are now hearing farmers who never before would entertain violence beginning to talk about it very seriously. We talked with knowledgeable law officials recently, and for a State trooper to say my colleagues and I are scared to death because the ammunition that is being stockpiled in these counties scares us, and I have attached here a telephone message which I took from the Jay, Oklahoma WAR, White Aryan Resistance that is being played and listened to by farmers. I think you will be interested in reading the transcription of that tape.

Oklahoma has been targeted, you are probably very much aware, to be organized by the KKK and the posse comitatus-type organizations. We will be doing some seminars to try to help farmers distinguish and begin to put that kind of thing down. But we believe that immediate and genuine policy changes must be made so that our offers of hope and the hope that was lifted up by the passage of this act can become reality and not just wishful thinking.

We appreciate all the energy and efforts that you are in and we look forward to these hearings and would work very closely with your subcommittee in doing hearings across our State and across the Farm Belt, because I think we strongly encourage you to get

out in the countryside and allow farm men and women to share their own personal experiences with you.

Thank you so much, Mr. Chairman.

[The prepared statement, with attachments, of Mr. Glenn follow:]

AG-LINK Coalition
P.O. Box 60288 Oklahoma City, Oklahoma 73146
AG-LINK Hotline: 1-800-AG8-LINK
(1-800-248-5465)

TESTIMONY OF DR. MAX E. GLENN
on behalf of the
OKLAHOMA CONFERENCE OF CHURCHES
and
THE OKLAHOMA AG-LINK COALITION
before the
Honorable David L. Boren, Chairman
SUBCOMMITTEE ON AGRICULTURAL CREDIT
UNITED STATES SENATE COMMITTEE ON AGRICULTURE,
NUTRITION AND FORESTRY
June 16, 1988

Mr. Chairman and members of the Committee: My name is Max E. Glenn. I am a farmer, minister and long-time rural advocate: born and raised in rural Oklahoma where my grandfather homesteaded in the "Cherokee Strip." I am the Executive Director of the Oklahoma Conference of Churches (OCC) and Coordinator of the Oklahoma AG-LINK Coalition. The Conference is the state-wide ecumenical organization representing 16 denominations. For the past three years we have provided significant leadership to facilitate grassroots response to the farm crisis. **Because of the urgency and extent of the rural crisis the OCC has developed and coordinated the efforts of one of the most far-reaching coalitions ever assembled in Oklahoma.**

Through a **statewide hotline and network of services** we respond to the now chronic problems facing farmers, ranchers, bankers, and businessowners and their families throughout rural Oklahoma. AG-LINK is a collaborative, service-oriented effort regularly involving 30 public and private agencies, organizations, and alliances, which also includes the strong participation of farmers, ranchers, and agribusiness representatives. (Exhibit No. 2)

Larry Hodges
Chair

Max E. Glenn
Executive Director
(405) 525-2928

Coordinated by the
Oklahoma Conference of Churches

I am testifying today at the invitation of the Committee and appreciate the opportunity to share our perspective on the implementation of the Agricultural Credit Act of 1987 as it relates to the Farm Credit System.

My remarks will be directed to you relative to four specific topics of extreme concern to our organization and to those we represent. With the time limitation imposed upon me, my remarks will be brief. But the support documents will further address the topics.

NO. 1 TOPIC: FARM CREDIT SYSTEM (FCS) PROCEDURES AND ACTIONS:

The FCS is proceeding with collection actions, foreclosures, and foreclosure proceedings while Farm Credit Administration (FCA) regulations are pending. The Act, Section 4.14A(b)(3), clearly states this is not to be done.

The type of, and language of, the "45 Day Notice" letter sent by FCS to the farmer with a distressed loan is very vague, extremely subject to misunderstanding, and frankly, quite disturbing in what it doesn't say. This letter is supposed to be a notification to inform the borrower (also a FCS stockholder) that the lender has determined the loan is or has become a distressed loan. However, the letter does not contain the word Notification.

I submit to you the letter is not clear and is not an attempt to be open or up-front with the farmer/borrower/stockholder. (Ref: AG-LINK Coalition letter to FCA, dated 6-9-88, page 6.) (Exhibit No. 1)

In summary, the borrowers' rights and the element of "consumers' rights" which the Act clearly recognizes, are apparently not of a high concern of the FCS. We are very concerned that FCS is doing things they aren't supposed to be doing, as well as not doing things they should be doing.

NO. 2 TOPIC: INCREASED ACTIVITY & INTENSITY INDICATORS OF FCS ACTIONS:

The Oklahoma "AG-LINK Hotline" telephone activities, which are a direct indication of farmers concerns and problems, are clearly increasing. Since the inception of the Hotline in October, 1985, over 30,000 telephone calls have been processed. Calls received in May, 1988 were increased by 47% in number over April, 1988. 78.5% of the calls received in May relate to FCS situations. Furthermore, the critical nature and intensity of the calls are alarmingly

increased. These telephone calls from farmers who are FCS borrowers are directly related to the topics I have already mentioned. It is also important to note attorneys of FCS borrowers are calling in reference to mediation in FCS cases. Our state has given leadership in the agriculture mediation procedure and it is being utilized. Presently 56 FCS borrowers are being prepared for and scheduled for mediation. Mediation to date has achieved an 86% settlement rate between farmers and creditors.

NO. 3 TOPIC: OKLAHOMA ATTORNEY GENERAL'S OFFICE:

The Oklahoma Attorney General's office has become concerned with the foreclosure actions and procedures of the FCS. Exhibit No. 4 contains a published article dated 6-9-88 from a major Oklahoma newspaper relative to the Attorney Generals concern. I submit to you that legal entities, as well as the farmers - borrowers and our organization, are concerned.

NO. 4 TOPIC: HUMAN COST ASPECTS:

In Oklahoma there are reportedly 1,380 FCS distressed loan customers-farmers. Our information indicates approximately 877 of those customers (farm businesses) have received the "45 Day Notice Letter." This indicates the intent of FCS to liquidate 877 businesses/farmers within a relatively short term of time.

This intent presents two disturbing possibilities. One - The elimination of 877 businesses/farmers is of tremendous economic and social impact within our state. If there were an announcement that 877 businesses were leaving the state within six months, I dare say all media, all govermental units, school districts, churches and chamber of commerce offices would take notice, and be moved to action. Two The elimination of 877 farmers/businesses does directly and immediately affect the rural small business community, and, by ripple effect, adversely affects larger businesses and metropolitan areas.

In a summarization aspect, the Federal Goverment has very adequately protected the rights of borrowers who are customers of commerical banks and savings and loan associations. You very wisely have instituted all necessary functions to regulate bank/savings and loan associations lending activities. We are, however shocked and disgusted at the apparent attitude of the FCS to place its self above **your** directives, the Agricultural Credit Act of 1987!

Using a good news - bad news concept, the AG-LINK Coalition and the Oklahoma Conference of Churches conducted a series of day-long **outreach workshops** state wide explaining the Agricultural Credit Act of 1987 and the mediation procedures. (Exhibit No. 5) Farm Credit Services officials participated in an apparent cooperative and supportative role. This role was greatly appreciated. The bad news is, this cooperative and supportive attitude has **not** been demonstrated by FCS when it came time to apply the Act and intent of Congress to their customers/stockholders! We are extemely dismayed that FCS has not supported mediation in the field, not followed the cooperative principles on which the co-op movement was founded. The co-op principles of owner controlled, local representation and a stockholder operated enity is being ignored. This is sad!

Oklahoma was the first state in this nation to be certified under the Act for farmer/creditor mediation. We were told federal matching funds would be available by March, 1988. We discovered not only they were not, but furthermore, they were not included in the FY 1989 budget proposals.

My friends, this nation needs the family farmer. This nation needs the food they produce that feeds you and I. **This nation and it's farm families need a strong farm credit system. But that system must be returned to cooperative and democratic principles.** You are the essential and critical govermental body delegated by the citizens of this nation to accomplish this function. We ask your help - we ask you to allow us to help you!

In my June 9, 1987, testimony to the full United States Senate Agricuture Committee I alerted you and your colleagues to the **"growing sense of anger, of outrage, of betrayal by 'trusted advisors at lending institutions and land grant colleges' and the threats of violence,** serious enough to cause county sheriffs and FCS officials to wear flak jackets at farm sales". We saw a temporary reprieve from talk about violence and the various financial and legal "scams" because of the **"new hope"** generated by the passage of the Agricultural Credit Act of 1987. **This hope is now fading into disillusionment.** Farmers are again listening to the extremists and organizers of hate-group activity. We have recently been in touch with knowledgeable law enforcement officals who tell us they are "scared to death" because of the increased efforts by these groups to stockpile ammunition and to network with and train disillusioned farmers.

Oklahoma has been targeted for concentrated organizing by those promoting the anti-democratic agenda of Posse Comitatus -type groups. I submit as Exhitit No. 3 a recorded telephone message from WAR (White Aryan Resistance), which is currently being generated out of Jay, Oklahoma. We and others like us are doing all within our power to counteract the far right recruitment, organizing, and propaganda efforts thoughout the farmbelt, but we cannot hold back the sea forever. **Immediate and genuine policy changes must be made so that our offers of hope are based in reality and not in wishful thinking.**

We respectfully call on you to honor your legislative committment to rural America and insist that the legislation's intent be brought to full reality.

We are not dealing with theoretical academic issues nor political postering. We are dealing with peoples lives! **I am outraged by the pain and suffering caused by the refusal of FCS and its regulators in the FCA to implement the letter and intent of Congress crafted so carefully in the Agricultural Credit Act of 1987.**

I strongly recommend that you continue these oversight hearings throughout the farmbelt and allow rural women and men to tell their own experiences. I attach one of the many which you would hear (Exhibit No. 6). I thank you on behalf of many distressed Oklahoma farm families and ranchers for this opportunity to testify. I will be happy to respond to question you may have.

Exhibits 1-6 follow:

EXHIBIT #1

AG-LINK Coalition
P.O. Box 60288 Oklahoma City, Oklahoma 73146
AG-LINK Hotline: 1-800-AG8-LINK
(1-800-248-5465)

June 9, 1988

Anne E. Dewey, General Counsel
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22101-5090

RE: Comments on FCA Proposed Regulations

Dear Ms. Dewey:

We appreciate this opportunity to comment on the FCA proposed regulations for the Agricultural Credit Act of 1987 published in the May 12, 1988, Federal Register. Our coalition is made up of some 30 organizations, state agencies, and religious groups. It is coordinated by the Oklahoma Conference of Churches. We operate a 24 hour hotline which has processed 30,000 calls from farmers and ranchers in Oklahoma in 32 months. These calls have confirmed the fact that FCA regulations and oversight is extremely critical. Hotline callers continually express their feelings of having lost control in the FCS, their borrower's rights, and financial viability. Our concerns are equally shared by Oklahoma Farmers Union, Oklahoma American Agriculture Movement, Inc., and Oklahoma Bar Task Force who are members of the AG-LINK Coalition.

As you know Oklahoma was the first state to become certified for Mediation under the Agricultural Credit Act of 1987. Oklahoma Conference of Churches has been contracted by the Oklahoma Department of Agriculture to administer the program. To date we have a success rate of 86% in the pilot phase of mediation. We feel that mediation, coupled with FCA regulatory oversight will insure stockholder/borrowers' rights, and restore viability of the FCS. Through working together we foresee a new day which will insure the survival of the family farm and the FCS.

We hoped that field hearings would have been conducted in Oklahoma before final regulations were published. Perhaps you will consider holding such a hearing at a later date. We urge you to consider our comments in developing the final regulations.

Sincerely Yours,

Max Glenn
AG-LINK Coordinator

Enclosure: Comments on FCA Proposed Regulations

COMMENTS ON FCA PROPOSED REGULATIONS
Published 5/12/88
Fed. Reg. Vol. 53, No. 92
Ron Johnson-Catherine Curry
AG-LINK Coalition

OVERALL COMMENT ON REGULATIONS: Regulations are supposed to give clear instructions for implementing the law. These regulations only restate the legislation which is also the same language in the FCS District policies. Congress would not have required policies and regulations if they didn't intend for borrowers to be provided with specific information that is necessary to utilize their new rights in the Agricultural Credit Act of 1987.

If the FCA continues to refuse to develop clear, concise, and consistent system-wide policy statements that go further than a mere restatement of the Act, perhaps the role of the FCA should be eliminated. Congress, in the form of Oversight Committees and Boards could deal directly with each of the District banks. Many stockholders/borrowers have not been afforded their rights under the new law since January 6, 1988, and the Farm Credit Administration has not been enforcing the law. There is a Credit Review process for those borrowers who want to appeal the decisions relating to debt restructuring, but, there should also be an appeals process and a right to an independent appraisal for those stockholders/borrowers who have not been afforded their rights pertaining to right of first refusal or access to mediation.

Since the new law has been in effect Oklahoma farmers have not been informed by FCS of their right to mediate, nor has FCS given stockholders/borrowers an opportunity to mediate until after being denied restructuring. This untimeliness inhibits the effectiveness of mediation and reduces borrowers' incentives to search for alternative repayment solutions. Congress intended for mediation to serve as a tool which would facilitate communications by opening up channels.

FCA should direct each district bank to develop a glossary of terms used in normal operations as well as in loan restructuring. This glossary should be made available to every stockholder. We have found that a clear understanding of the terminology helps to facilitate negotiations between borrowers and lenders.

The term "adverse action" must be clearly defined in the regulations and all borrower responses to this determination should be clearly presented in all correspondence to the borrower.

The Ninth Farm Credit District, Wichita, Kansas, was required by the Agricultural Credit Act of 1987 to submit a policy governing the restructuring of distressed loans to the Farm Credit Administration within 60 days of enactment.(The Act SEC.4.14A (g) (1-3)). This policy must comply with the letter and intent of the Act , and conform to FCA regulations set forth in the Code of Federal Regulations (12 C.F.R.). The Ninth District's policy was submitted to FCA for review

in February. Although comments must be directed to the Proposed FCA Regulations, the District/Associations' policy represents a third dimension relative to the Agriculture Credit Act of 1987, and the regulatory authority of the FCA's Code of Federal Regulations (12 C.F.R.). The District/Associations' policy governs and closely affects stockholders'/borrowers' day-to-day affairs. This policy has been incorporated in the review comments to insure its provisions are not written or administered independently of the Act, or the FCA's Code of Federal Regulations.

Part One reviews the Act and compares its letter and intent with FCA's proposed regulations. District/Association policy is discussed in relation to its compliance in carrying out, and administering the Act through the Code of Federal Regulations. Since FCS is administering restructuring prior to FCA regulations, Part One is directed toward field reports from stockholders/borrowers who have received restructuring notices from the FCS, and their experiences in going through that process.

Part Two is a section by section review of issues which, if implemented through FCA proposed regulations, could restrict stockholders/borrowers in obtaining their full borrower's rights intended through the Agricultural Credit Act of 1987.

PART I

I. ISSUE: FCA should not permit FCS District/Associations to proceed with collection action, foreclosure, or foreclosure proceedings while FCA regulations are pending.

THE ACT	FCA REG	FCS NOTICE/POLICY
4.14A.(b)(3)	614.4515(a)(1)	N/A

A. The Act Section 4.14A (b) (3) makes it clear that: "No qualified lender may foreclose or continue any foreclosure proceeding with respect to any distressed loan before the lender has completed any pending consideration of the loan for restructuring under this section."

It is clear that Congress intended for the starting line on foreclosures to begin after the final regulations were published. Since Congress required the FCS to submit their restructuring policies to FCA for review, and the FCA to submit their regulations governing those policies for public review, it is logical to assume that no stockholder's/borrower's loan should be subjected to FCS policy before such policy has been reviewed through FCA regulation. Effectuating policy before a regulation would create a third dimension independent from the Act and the Federal Regulations. - Therefore, until FCA publishes its pending regulations into final form, qualified lenders should not foreclose or continue any foreclosure proceeding.

B. FCA REGS. Section 614.4515 (b) states that: "Beginning on July 6, 1988, and every 6 mo. thereafter until January 6, 1993, each qualified lender shall submit semiannual reports to the Farm Credit Administration containing:

(1) The results of its review of its distressed loans, conducted in order to determine which loans are suitable for restructuring; and
(2) The financial effect of loan restructuring and liquidations on the lender."

Obviously, FCA intends to analyze FCS reports as to how many loans are or may become eligible for restructuring, and how restructuring or liquidating these loans may affect the District. It would, therefore, be inappropriate and misrepresentative for the FCS to take any action toward denying restructuring, appeal of denials, or liquidation until after July 6, 1988. Any actions taken prior to this date would make it impossible for the FCA to review the status and affect of these loans

until after the fact. FCS should submit a full report to FCA for review before any restructuring, collection, liquidation, restructuring denials, appeals, or any other procedures governed by the Act are initiated. Any action taken outside the Act or the FCA Code of Federal Regulations would circumvent the FCA's authority, deprive stockholders'/borrowers' oversight from the United Stated Government, and prohibit citizens' effectual impact through commenting on proposed regulations. It is clear that Congress intended for the starting line on foreclosure action to begin after the final FCA regulations were published.

DRAFT COMMENT:

Section 614.4515 should contain a subparagraph between Section 614.4515 (a) and Section 614.4515 (b) which provides that no qualified lender may foreclose or continue foreclosure before the lender has complied with Section 614.4515 (b). This will insure FCA's review before the fact.

II. ISSUE: Each restructuring document sent must conform to the notification requirements of the Act, and the FCA's Code of Federal Regulations, and each stockholder/borrower must be properly notified.

THE ACT	FCA REG	FCS NOTICE/POLICY
4.14A.(b)(1)	614.4516(a)	Cover letter

A. The Act, Section 4.14A.(b)(1) states that:

"(b) NOTICE--

(1) IN GENERAL-- On determination by a qualified lender that a loan made by the lender is or has become a distressed loan, the lender shall provide written notice to the borrower that the loan may be suitable for restructuring, and include with such notice--

(A) a copy of the policy of the lender established under subsection (g) that governs the treatment of distressed loans; and

(B) all materials necessary to enable the borrower to submit an application for restructuring on the loan.

(2) NOTICE BEFORE FORECLOSURE--Not later than 45 days before any qualified lender begins foreclosure proceedings with respect to a loan outstanding to any borrower, the lender shall notify the borrower that the loan may be suitable for restructuring and that the lender will review any such suitable loan for restructuring, and shall include with such notice a copy of the policy and the materials described in paragraph (1)."

This section is appropriately entitled "Notice". The District/Associations are required to provide financially stressed stockholders/borrowers with a written notification. The written notification, required by the Act, is being sent in the form of a cover letter which fails to give the stockholder proper notification as Congress intended. The fact that Congress used the word "notice" six times is indicative of their intent that each stockholder who has a "distressed" loan be properly notified.

The cover letter being sent, pursuant to the written notification requirement, does not explain to stockholders/borrowers that the letter is, in fact, a NOTIFICATION THAT THE LENDER HAS DETERMINED THAT THE LOAN IS OR HAS BECOME A DISTRESSED LOAN. Moreover, the letter does not contain the word "notification". The Ninth District/Associations have mailed the written notification cover letters to stockholders/borrowers who have delinquent loan payments. Many of these recipients have misunderstood the serious, underlying meaning of this letter, and have failed to respond within 45 days. Unfortunately, the letter does not inform the reader of consequences which may result from missing the 45 days. Rather, the letter leaves the reader with the impression that the District/Associations are explaining that they have adopted a new program and are giving the reader the opportunity to participate.

The cover letter reads as follows:

Dear Mr./Mrs.

Pursuant to the Agricultural Credit Act of 1987, the Ninth Farm Credit District has adopted a Loan Restructuring Policy under which your loan may be suitable for restructuring. Enclosed is a copy of that policy.

In order to be considered for restructuring, the enclosed application and supporting information listed below must be completed and returned within forty-five (45) days of the date of this letter.

1. Application for Restructuring - Must be fully completed and signed by all parties liable for the loan.

2. Balance Sheet - Must be fully and accurately completed on the enclosed form to include all assets and liabilities. A different form may be used if it provides comparable information and detail. Each liable party must provide a complete balance sheet (husband and wife may submit a single balance sheet if assets are held jointly.)

3. Operating Statement - The right-hand column should be used to project income and expenses for the next operating year. Use the remarks section on the reverse side to explain the restructuring plan and operating assumptions which are the basis for the projected income statement. The left-hand column should document income and expenses for the previous two operating years. Complete the operating information on the reverse side of the form.

4. Information Disclosure Agreement - Must be completed and signed by all liable parties submitting financial information.

5. Income tax returns for the previous three years.

If you have accountant prepared financial statements, please provide the necessary statements to satisfy the information requirement in items #2 and #3 above.

If you wish to discuss restructuring alternatives, please call (officers name) at (number) for an appointment.

Legal action to collect your loan will continue if no application is received or if restructuring your loan is not approved.

Sincerely,

Loan Officer

SEVERAL SERIOUS PROBLEMS HAVE RESULTED IN THIS DOCUMENT BEING USED AS NOTIFICATION TO "DISTRESSED" STOCKHOLDERS/BORROWERS AND MAY RESULT IN THE LOSS OF HUNDREDS OF OKLAHOMA FAMILY FARMING BUSINESSES WHO HAVE MISUNDERSTOOD ITS CONSEQUENCES.

Although the District/Associations have not provided an accounting of how many stockholders/borrowers have been sent these notices they have confirmed that a large number of stockholders have not responded to these notices. The District/Associations are now making it clear that failure to respond to these notices will result in the stockholder(s) losing their rights to be considered for restructuring under the Agricultural Credit Act of 1987. The District/Associations initial experience with relatively low response levels can best be understood by examining the contents of the letter.

The District/Associations fail to explain in the first paragraph, for example, that the stockholder's/borrower's loan may not be suitable for restructuring. Omitting the use of consequential language has grossly distorted the reader's perception of the seriousness, authority, and/or intent of the lender's notification. The first paragraph has merely indicated that the stockholder/borrower may qualify for some new program which the District/Association has adopted.

The second paragraph, likewise, fails to explain to the stockholder/borrower the authority of the District/Association to terminate his/her borrower's rights of restructuring under the Act if all requirements are not met within the 45 days. The 45 day requirement, as stated, is in fact a dead-line. Unfortunately, stockholders/borrowers have misunderstood the meaning of this dead-line requirement by believing that the 45 days would be used to compile preliminary information, complete income tax returns as required, schedule mediation, as provided in the Act, and begin formulating plans toward a restructuring proposal.

Perhaps more serious, the second paragraph says nothing about the fact that the 45 day requirement is a result of Congressional Legislation which, if ignored, could result in the District/Association's decision to accelerate the loan, causing the entire loan balance to become due, terminate the District/Association's responsibilities to restructure under the Act, and a loss of borrower's rights. Should a stockholder/borrower be unable to pay the loan in full, the District/Association could file a foreclosure suit in court for debt collection.

The District/Association's failure to receive responses to large numbers of notices being sent could be avoided by inserting proper notification language.

B. FCA PROPOSED REG. 614.4516 (a) Must instruct FCS on specific notification requirements.

III. ISSUE: FCA SHOULD REQUIRE FCS TO GIVE STOCKHOLDERS/BORROWERS THE OPPORTUNITY TO MAKE WRITTEN APPLICATION.

THE ACT	FCA REG	FCS NOTICE/POLICY
4.14A.(a)(1)	614.4515(a)(1)	pg.2 Application

A. The Act, Section 4.14A. (a) (1), requires stockholders/borrowers to submit a "written application" as part of supportive information required by the District/Association.

The Act, Section 4.14A. (a) (1) (A) states that this application shall be submitted:

"...from a borrower for the restructuring of a distressed loan in accordance with a preliminary restructuring plan proposed by the borrower as a part of the application..."

The Ninth Farm Credit District provides the "application" as required by the Act, and explains in the notice letter that the "application" "Must be fully completed and signed by all parties liable for the loan."

The "application for restructuring" form provided as a part of the notification requirement (Sec. 4.14A. (b)), requires the stockholder/borrower to "State in detail the exact terms of your restructuring proposal. Be clear and specific in your proposal. Use the reverse side if necessary."

Requiring the applicant to state exact and specific terms of his/her proposal overrides Sec. 4.14A. (a) (1) (A) which only requires the application to support a preliminary plan.

The "application for restructuring" form further complicates stockholder's/borrower's understanding by contradicting itself. The second sentence of the last paragraph states that "I (we) understand that this application is not complete, and will not be processed or treated as a complete application, until all of the financial information requested is furnished to the lender".

First, the language used here distorts the reader's initial perception by implying that even though one cannot furnish complete information at the time of the application, the District/Association will accept best-guess estimates without making restructuring decisions based on them.

Secondly, the District/Associations have made it clear in public meetings that submitting "all" of the financial information would be a process which would evolve through a meeting, series of meetings, mediation, and possibly the District/Association introducing its own plan of restructuring as authorized in the Act Sec. 4.14A. (d) (2)

B. FCA REG. SEC. 614.4516 (a)(1) states that:

(1) Loan restructuring are to be accomplished in accordance with:
(a) The policy adopted by the district board of directors under section 4.14A(g) of the Act.

FCA has given FCS full authority to write its own regulations. By allowing FCS this discretion, stockholder's/borrower's day-to-day business will be governed by policy as interpreted by the FCS, rather than FCA regulations.

DRAFT COMMENT:

Section 614.4516(a)(1) should be re-written, stating the specific language of the Act Section 4.14A(g) with additional instructions explaining how FCS must obtain FCA approval of policy.

920681 O - 89 - 17

DRAFT COMMENTS ON FCA PROPOSED REGULATIONS
Published 5/12/88
Fed. Reg. Vol. 53, No. 92

PART 2

The following are questions and concerns regarding the proposed FCA regulations, 12 CFR parts 614, 615, and 618, Federal Register, May 12, 1988.

General Problems

--The regulations are simply restatement of the legislation. Many terms and conditions are left undefined. This ambiguity will allow each district to implement and enforce the legislation differently. The legislation should be uniformly implemented.

--The regulations fail to follow statutory intent. The FCA had the authority and duty to design the regulations in such a way that farmers would be provided with as many opportunities as possible to continue farming, but failed to do so.

Specific Problems

1) Section 614.4517 - Restructuring Decision.
This section is the heart of the borrower's rights provisions. It is crucial that farmers be given clear instructions on what calculations are involved in the restructuring process. The regulations should define each cost of restructuring and each cost of foreclosure and the calculations needed to reach each of these. The regulations are incomplete on this point, and again merely restate the legislative provisions. This will allow individual districts and loan officers to subjectively define what are "necessary and reasonable living and operating expenses," and what are necessary "management skills" and "financial capacity." This in turn will lead to non-uniformity among the districts.

2) Subpart N - Loan Servicing Requirements.
Section 614.4512 - Definitions.
Definitions pertaining to "cost of foreclosure" are wholly inadequate. They provide nothing past what was written in the legislation. Regulations are supposed to be written so that a piece of legislation can be implemented. Terms and conditions should be specified. In the comments section, it states that "a regulation cannot exhaustively list what all costs are." A regulation need not list every conceivable cost, but should list the largest costs or most common costs. The comments also say that the costs cannot be listed because "they may vary from state to state and possibly even loan to loan." The actual costs will vary but the calculations to figure those costs should not. We believe it is unrealistic to expect farmers to develop plans without these all important calculations.

As in the act, "application for restructuring" is defined as a written request in accordance with a Preliminary restructuring plan. In our district, as in many others, this application is considered final, and the farmer is not allowed to submit any additional proposals. A clearly written regulation that spells out exactly what the stages and timelines for a preliminary restructuring phase are, would go far to insure that a farmer is not deprived of his property and livelihood without due process of law.

3) Section 615.4518 (d), Denial of Restructuring.
FCS should be required to provide calculations and critical assumptions in the restructuring denial letter along with other tangible reasons for the denial of restructuring. It seems fair that FCS should provide stockholders/borrowers with an equal amount of disclosure information as being ask for. Borrowers should be provided with all work sheets, appraisals, signed documents, and an exhaustive list of cost which were used to determine the "cost effectiveness" of restructuring versus foreclosure.

4) Section 614.4518 Notice of Denial of Restructuring and Right of Review.
In order to adequately prepare himself/herself for an appeal of a denial of restructuring, a farmer needs the exact information that the FCS officials used in their determination. This information should include the calculation sheet and all figures involved. In addition, because the time period for requesting appeals is so short, FCS institutions should make every effort to aid the farmer in knowing when and how to make his/her appeal. At the very least, the 7 day deadline should be in bold print in a conspicuous place. FCS institutions should also include a separate form to be used for this specific purpose. This will further enable farmers to exercise their appeal rights.

6) Section 614.4519 (c), Notice Before Foreclosure:
Limitation On Foreclosure, should specifically state that FCS shall not foreclose, or continue with any foreclosure until all administrative procedures provided in the Act have been exhausted. FCS should be required by FCA to explain to stockholders/borrowers the procedural steps which will be taken before and after restructuring applications are considered.

7) Section 614.4522 - Right of First Refusal.
Many districts are attempting to circumvent congressional intent by holding only public auctions of inventoried land. This loophole should be closed by a specific section in the regulations. All districts should be required to follow the Omaha District's example and use public sales as a last resort as congress intended. Private sales allow a farmer to exercise his right of first refusal where a public sale does not.

8) Section 614.4521 - Participation in State Agricultural Loan Mediation Programs.
In the Oklahoma jurisdiction, FCS officials have been very hesitant to delay their actions on restructuring plans until after a mediation hearing has been completed. We believe that farmers who request mediation should be allowed to participate before they exhaust their administrative remedies. The regulations provide that system institutions shall participate in mediation either concurrently with loan restructuring under Section 614.4517 or at any other appropriate time. We feel, through our experience with the Oklahoma Agriculture Mediation Program, that mediation is not appropriate after a final administrative determination. The ideal time for mediation is during the preliminary restructuring phase, or before the 45 day period has begun. It should not be a hardship on FCA officials to postpone credit review until after a mediation can be scheduled.

9) Section 614.4367 (B) (2), Waiver of Rights.
If a loan is being pooled, the borrower will be asked at closing to sign a waiver of rights to restructuring. This information is necessary for the borrower to make a sound business decision on the choice to have the loan pooled. A model form for the waiver should be included for comment and should be used by all FCS districts for consistency in the waiver provision.

10) Section 614.4367 (C) (3) Factors Taken Into Account in New Interest Rate.
The portion of the statement "other than standard adjustment factors" should be deleted. Stockholders/borrowers are not usually well schooled on what factors are typically taken into account by a lender when adjusting the interest rate. All factors should be listed, standard or otherwise. This notice should be provided at least 30 days in advance to enable borrowers to consider possible options to switch lenders.

FCA should require FCS institutions to publicize the loan review process so that borrowers have the opportunity to have their current interest rate reviewed to see if they are eligible for a new, lower rate. This change could help keep the loan from becoming distressed in the future.

11) Section 614.4367 (d) and (e) Require Disclosures.
Any actions to change amount of stock or participation certificates required by borrowers should be provided in writing 30 days, not 10 days, before such action can take effect. In loans with more than one obliger, the proposed regulations for this entire section should clearly state that all disclosures should be received by all parties affected.

12) Model Disclosure Forms:
We question why the model forms submitted for public comment are for optional use by FCS Districts. What is the purpose of public comment on the forms if they are not required for use by all FCS Districts? It

seems that FCS Districts should have to use a standard form to insure that borrowers are receiving consistent information. FCA should take a strong position on standard forms and letters to minimize confusion. Failing to require the use of a standard form will cause continued discrepancies between districts with similar results such as the 45 Day Restructuring Letters where borrowers in different districts received very different letters which in some cases were wrong and in other cases were very misleading.

13) Section 614.4440 Definitions.
The policy statement of the qualified lender system-wide should state very clearly that a restructuring request must be in writing. Loan officers should be directed to give the borrower a copy of the policy statement in writing. Casual visits with loan officers and comments that one is not eligible and should not apply are often taken by farmers as firm denials. The loan officer should not be making comments concerning the individual borrower's eligibility until all written supporting documents have been received.

14) Section 614.4440 (C) (3) Application for Restructuring.
FCA regulations should clearly state what type of information is required as part of the application and to clearly define a "preliminary restructuring plan". The borrower should be furnished with a list of all the sufficient financial information and repayment projections required by the lender. Too many times the application is denied for lack of data or the borrower was accused of not acting in good faith since data was not supplied that has only recently been deemed necessary. A change from requiring 3 years of past tax returns to 5 years is an example.

15) Section 614.4440 (D) (1), Distressed Loans.
It is not clear that a borrower demonstrating adverse financial and repayment trends refers only to FCS or to all other accounts of the borrower. Does it apply to a borrower who has kept his/her FCS loan current and yet is behind on operating loans through private vendors for feed, seed, etc? This should be addressed and made very clear in the policy statement of the qualified lender system-wide. The clause, "as determined by the lender" should be deleted since it narrows the definition in the Act by not letting the borrower initiate the contact if they are aware that they will be unable to meet upcoming payments prior to the lender becoming aware of the situation. Resolving potential delinquent payments at the earliest possible time is in everyone's best interest.

16) Subpart L - Actions on Applications; Review of Credit Decision.
614.4442 - Credit Review Committee.
We believe that it is important that one member of the Credit Review Committee be a farmer. In the FCA comments on this section, it states that, "the FCA finds nothing in the 1987 ACT or its legislative history to support adopting a different approach at this time." We disagree. One of the most important underlying objectives of the new legislation is to place the system back into the hands of the borrowers as the

system was originally designed. Placing a farmer on the Credit Review Committee would further this objective.

17) Part 614 - Loan Policies and Operations.
Subpart K - Disclosure of Loan Information.
Section 614.4367 Required Disclosures - In General.
We believe that the addition of a citation for the Truth in Lending Act is very important. The types of financing that farmers face is often much more complicated than that which ordinary citizens face. This complexity makes full disclosure necessary. The application of the Truth in Lending Act will provide farmers with the same safeguards that ordinary consumers are entitled to.

Is there a defined role for participating in the meeting itself? The stockholder/borrower seeking a review by a credit review committee should have the option with due cause to refuse at least one member of a Credit Review Committee if he/she can show that such person may be biased against the borrower. The borrower should be informed in writing of both the right to appear in person before the Credit Review Committee and what documentation will be considered. The proposed regulations are not clear. FCS should not issue time guidelines for these meetings. Many borrowers are required to travel long distances for these meetings and are being notified that the meetings will only last one hour. Some borrowers have been told that the Credit Review is not important. The FCA regulations should clearly outline the function of the Credit Review Committee including both eligibility for serving on the Committee and the importance of the Credit Review process being an independent and fair appeals process. The regulations should clearly state that the meetings should be in a neutral location, not in the FCS office.

18) Section 614.4440 (G) Restructuring.
The borrower should be clearly informed as to what criteria have to be met and what actions must take place to meet their definition of a financially "viable" operation. The loan officer and the borrower should be clear as to what standards must be met to pass this test. For example, is it debt-to-asset-ratio, or some other financial measurement that determines "viability."

19) Section 614.4441 (A), Notice of Action on Loan Application. The tangible reasons for the decision of a qualified lender should be provided to all parties involved on the loan under consideration. These tangible reasons should include all computations and assumptions used to make the decision on the loan.

20) Section 614.4443 (c), Credit Review Process-Independent Appraisal. Independent Appraisers which are placed on the accredited list should not have been employed by FCS or FmHA for appraisal work for the last two years. Borrowers should be allowed to select from other counties to insure a fair and impartial appraisal.

21) Section 614.4516 (b)
The borrower should be clearly informed of an opportunity to meet personally with the lender. The only reason for no personal meeting is for the borrower to decline in writing the need to meet personally with the lender. The borrower should have the option of meeting with a different loan officer or representative of the lender in cases of personality conflict or communication breakdown.

The required disclosure should require FCS to make a counter- proposal to a borrower who submits an initial plan of restructuring that is not acceptable. Good faith negotiations include both sides participating in the process. If the farmer has figures and assumptions that are unacceptable, then it is the duty of the loan officer to clearly state the reasons for the denial. Farmers have been receiving rejection notices with little explanation of why their preliminary plans were in fact rejected. The only option being presented is an appeals process, not an opportunity to submit alternative proposals or negotiate a compromise.

22) Section 614.4517-Restructuring Decisions
This entire section contains terms that must be clearly defined. (a)(2) What standard is being used to determine "necessary and reasonable living and operating" expenses? This is a very subjective criteria in the debt restructuring application.

(a)(3) What does "financial capacity and management skills to protect the collateral from diversion, dissipation, or deterioration mean"? Who defines these skills? It seems that a farmer's current financial situation should not be taken into consideration. These terms are very subjective determinations. If they do form the basis for an adverse decision, they should be part of the borrower's file and available in the case of an appeal.

(a)(4) The term viable needs to be defined.

(a)(5) In this paragraph, the use of "sound lending practices" seems to mean something different than the least cost alternative in the decision between restructuring and foreclosure. This needs to be clarified as to how and why this situation will be treated differently than any other restructuring procedure. The borrower and the lender should be allowed to develop a written agreement enabling the borrower to make a payment late if sound farming or marketing practices dictate without going against "sound lending" practices.

23) Section 614.4517 (C)(1) Evaluation of Cost of Restructuring The formula and calculations used in determining the cost of restructuring must be given to the borrower and not just considered by the lender.

(c)(1) What does present value of interest and principal foregone by the lender mean? This is a term that is not easily calculated by borrowers or accountants and must be clearly explained.

(c)(2) There should be a definition of reasonable and necessary costs with a list provided.

(c)(3) The legislation, regulations, and the district policies all discuss "preliminary plans"; yet, borrowers are being told that these plans, once submitted, cannot be changed. These initial plans should be subject to change based on different factors including farm plans, projected income, appraisals, and weather conditions.

24) Section 614.4518 Notice of Denial of Restructuring and Right to Review

All calculations and information used by FCS officials in their determination should be provided. This should include the calculation sheet. The borrower should be informed of any state mediation programs if this information has not been provided prior to the denial of a restructuring plan. All parties involved with the loan in question should be notified in writing of the denial of restructuring and the written notification of a review procedure.

Since the 7 day time period for requesting appeals is so short, FCS institutions should make every effort to aid the farmer in knowing when and how to make his/her appeal. At the very least, the 7 day deadline should be in bold print in a very obvious place on the letter. There should be a separate form to send back to request the appeal. The 7 days should not begin until the borrower actually receives the notice. These should be sent certified mail so that the receipt date can be verified. An additional seven days should be allowed when the notice is sent to a third party only, such as an attorney, accountant or other representative.

25) Section 614.4519 (b) Limitation on Foreclosure

We believe the law is very clear that all borrowers were intended to have the right to attempt restructuring to be able to remain on their farms. In cases where the FCS had received a foreclosure judgement but had not yet taken the land into inventory FCS is not allowing these borrowers opportunity to apply for debt restructuring under the new law. These farmers have not had the same access to documents we believe is provided for under the new law. They have not had the opportunity to have an independent appraisal to be considered in the decision to foreclose. This is another case of where FCS needs to make a clear statement to carry out the intent of Congress. This clear statement would go a long way toward reducing the litigation cost being incurred by the system. Loan officers should be charged with carrying out the intent of the law and not allowed the discretion to second guess or interpret the law. Worse yet, expensive attorneys should not be employed to find loopholes in the law to circumvent borrowers' rights.

26) Section 614.450: Review of Restructuring for Certified Institutions:

We believe the special asset groups should review all determinations that a loan will not be restructured. We also think it should be made

clear what the farmer's rights are if indeed the special asset group finds that his loan should have been restructured. This is especially important for those people forced off their farms when they should have been allowed to stay.

27) Section 614.4522 Right of First Refusal
(a)(2)(b) The determination upon acquiring property as to whether the previous owner "had the financial resources to avoid foreclosure" should not affect the farmer/borrower's right of first refusal. This paragraph should be eliminated. The decisions of the past and the conditions that led to that decision should not be held against a previous owner. All previous owners should be given the right of first refusal, as Congress intended, and their purchase and/or lease options should be judged on present merits and conditions.

The 15 days for farmers to respond to notification should be 30 days since the 15 days was a typographical error in the legislation that has been corrected in the pending technical amendments. This time frame should be for responding only. No one should be pressed to have a deal completed within this time frame. Previous owners should be allowed adequate time to seek financing much as is allowed in any other real estate purchase agreement. The time frame should be based on business days not calendar days.

FCS should consider financing the acquired property if the same conditions and terms can be met by the previous owner as would be required by a new owner/borrower. Terms and conditions do make a difference as to whether a property will cash flow. All decisions to reject the right of first refusal should be appealable, as well as all determinations used to deny right of first refusal; also the offer to purchase and/or lease with option should be provided to the previous owner in writing.

28) Section 614.4522 (E) Public Auction
The proposed regulation should be clarified to clearly state the previous owner's right to purchase the property at appraised market value before a public auction. Deleting the phrase, "except as provided in paragraph (e) from the beginning of Section 614.4522(c) and 614.4522(d) would ensure that the regulations are not going against Congressional intent in the use of public auctions to avoid the right of first refusal provisions of the law. Recent court decisions have found ongoing FCS actions illegal.

Property should have to be in inventory a minimum amount of time after it has been offered to the previous owner before it can be sold or leased to anyone other than the previous owner except where the owner has waived all rights of first refusal in writing.

This waiver should only be accepted after it has been documented by the loan officer that the previous owner has been fully informed of his right of first refusal. This is necessary to prohibit loan

officers from making personal judgments regarding the previous owner's right to start over or to regain access to a piece of property.

Many loan officers have taken it upon themselves to determine who farms and who does not. These are the loan officers who have begun to use public auctions as a way to circumvent a previous borrower's right of first refusal. We believe these loan officers are mandated to carry out the law and not to interpret it. We believe it is the duty of FCA to investigate these practices.

29) Homestead Protection:
The proposed regulation needs to be modified to clearly implement the Statement of Manager's understanding that Right of First Refusal includes provisions granting "homestead" protection to troubled FCS borrowers. This could be done by replacing the phrase, "the right to purchase (or lease) the property", with the phrase, "the right to purchase (or lease) the property or any portion of the property." A new section in the proposed regulations would be necessary to cover appraisals.

30) Section 615.5255 Retirement of Capital Stock
A borrower should be allowed to retire stock against the outstanding principal whether or not the principal was reduced. This has not been addressed in the regulations. This would allow the borrower to reduce his debt and leave less stock for the system to guarantee.

Max E. Glenn, Coordinator

Ron Johnson, Farmer Consultant

Catherine Currey, Attorney

EXHIBIT #2

AG-LINK Coalition
P.O. Box 60288 Oklahoma City, Oklahoma 73146
AG-LINK Hotline: 1-800-AG8-LINK
(1-800-248-5465)

AG-LINK RESPONSE TO OKLAHOMA'S RURAL CRISIS

The AG-LINK Coalition

Because of the urgency and extent of the rural crisis, the Oklahoma Conference of Churches, a statewide non-profit organization, has developed and coordinates the efforts of one of the most far-reaching coalitions ever assembled in Oklahoma. The AG-LINK Coalition was formed in 1985 in response to the farm crisis in rural Oklahoma. The Coalition now includes 30 groups from across the state (see attached) and is being used as a model for similar groups across the country. The AG-LINK Coalition brings together:

The faith community of local congregations and denominations.

Vocational and Professional Organizations including farm organizations, electric cooperatives, labor unions and others.

Educational institutions including several departments of Oklahoma State University, Langston University, the University of Oklahoma School of Law and Phillips University Graduate Seminary.

Legislative and executive branches of state government including the State Departments of Agriculture, Human Services, Education, and Mental Health, the Senate and House Agriculture Committees, and County Commissioners statewide.

The legal community including the Oklahoma Bar Association, Legal Aid of Western Oklahoma, and Legal Services of Eastern Oklahoma.

The AG-LINK Coalition, coordinated by the Oklahoma Conference of Churches, is farmer-rancher controlled and links its member groups and existing resources in a manner acceptable to the rural community.

The Farm Crisis Hotline

Direct, immediate communication with farmers and their families in crisis is provided through the toll-free AG-LINK Representative hotline. The statewide hotline, answered in the OCC offices, is supported by supplementary funds from Willie Nelson's Farm Aid program, the Oklahoma Department of Agriculture, Oklahoma Farmers Union, Farm Bureau, Wichita Farm Credit System, the American Agriculture Movement, the Oklahoma Conference of Churches, Church Women United, local congregations, individuals, and several denominations: United Methodist, Roman Catholic, Christian Church, United Church of Christ, Episcopal, Presbyterian, Baptist, Mennonites, American Baptist.

The AG-LINK Farm Crisis Hotline in its first 30 months of operation has processed 27,960 calls. The numbers of calls continue to increase in both number and intensity -- March 1988, 1,491 calls processed compared to average of 1,000 per month in 1987. AG-LINK counseling staff and volunteer care-givers have intervened successfully in 68 threatened suicide cases. Even the most seasoned veterans of the farm crisis have been stunned by the hotline activity. This direct and personal contact has proved invaluable both for farm families with severe needs and for those who manage and administer the resources to meet those needs. Direct crisis intervention and referral to existing programs and resources occur daily. Often, calls reveal immediate needs in one of these categories:

*Counseling intervention and referral in cases of severe depression, acute sense of loss or loneliness, intense family problems, obsessive anger and even threats of imminent suicide.

*Physical, life-sustaining needs for food, shelter, heat. Emergency aid is available and often dispatched immediately to meet urgent demands. Referrals and guidance are necessary for families who have never faced severe deprivation and simply don't understand the methods of survival in such conditions.

*Legal assistance, referral, and guidance for those who are under immediate pressure but have no resources to obtain legal services.

*Referrals to farm management advisory programs at OSU's IFMAPS program and Vo-Tech's, tuition-free vo-tech training and other programs which are available but not widely known.

*Referrals to Agricultural Mediation Program (AMP), Oklahoma's Farmer/Creditor Mediation, the first in the United States to be certified under the new Agriculture Credit Act of 1987 is sponsored by the Oklahoma Department of Agriculture and operated by AG-LINK. Mediation has achieved an 86% settlement rate between Farmers and Creditors.

*Emotional support through formation of local support groups which are, in turn, linked to specialists in their geographical areas.

*Referrals to local churches, ministers, and farmer-to-farmer networks.

*Dissemination of information pertaining to government regulations and policies, legislative and judicial decisions, and environmental standards which affect Oklahoma farmers.

In addition to the AG-LINK Hotline, other AG-LINK goals and activities include: education and public awareness, coalition and network building, advocacy in the public policy arena on behalf of Oklahoma's rural community, mobilization of the religious community for justice, and community organizing.

EXHIBIT #3

W A R
(White Aryan Resistance)
Heartland Division
P. O. Box 265
Jay, Oklahoma, 74346
(918) 253-4363

Recorded message at above number, which is being circulated among farmers.

June 10, 1988

RECORDED MUSIC: Country Western music. [Some lyrics not distinct and are designated by ( ).] "I see the (bad) moon arisin'. I see some trouble on the way. I see --------- arisin'. I see (some bad clouds today). Don't fool around tonight. (Earth's) bound to take your (sight). --- out the --- on the right. (I feel ---- change a blowin') I know the end is comin' soon. I (feel) the river overflowin'. I hear the voice of---------- Don't fool around tonight. (Earth's) bound to take your (sight). (There's a bad moon on the right? or rise?)"

VOICE: "This is WAR (White Aryan Resistance), Heartland Division, P. O. Box 265, Jay, Oklahoma, 74346; with a message for the white working people and others. There are thousands of organizations working for the interest, ideals and cultures of all kinds of minority people, whether they be Mexican, Indian, Jewish, Black, or what have you. How many organizations can you name that stands up and fights for the interest, ideals and cultures of the white people? Not many. As a result, **the White Aryan Resistance is organized across the United States, nationwide, to fight for our people, for our interest, and our cultures. WAR has many enemies, WAR has many friends.** We do not consider an enemy of WAR to be someone of another color, just because they've got a different color of skin. We recognize other races of peoples' right to stand up and fight for their interest, ideals, and cultures.

"Recently, a couple of years ago, in Arizona, when this rotten speakin', filthy, lying United States Government tried to take away land from the Indian people - they had promised the Indian people years ago - the Indian decided to rise up and fight for their land. Our leader, Tom (Met----), the White Aryan Resistance, got in touch with these Indian people and offered our help. We recognize their right, and we recognize the right that the Government had lied to them on many occasions and they were gettin' screwed over just like we'd been getting screwed over. So, ladies and gentlemen, we offered our assistance and our help. And, we will continue to do this. We've set down with many Black nationalists, Indian nationalists, Mexican nationalists and what have ya, and our conversations have been fruitful on many occasions.

"You know we're the main people - You want to talk about **enemies of the White Aryan Resistance** - There are people of our own race, these rich monopoly capitalists who control the United States Government. They are rotten, filthy, vile, men who have sent our boys off to die on foreign land for no-win wars for capitalistic monetary gains; and we're

sick and tired of seein' our men die. This Government starts that crap again, we'll put people on the streets and they're going to have a war right here in the United States! So, they'd better back off!

"Now, I'm gonna tell ya somethin', people, the White Aryan Resistance is a tight organization. If you come join the White Aryan Resistance, and you get in with us, you're getting into a very tight, family, organiza- tion that treats each other like brothers and sisters; and anybody messes with one of us, they mess with all of us! And, if you're one of these people out here that's contemplating trying to hurt any member of the White Aryan Resistance, I don't care who she might be, or who he might be, then I guarantee ya, there will be no place for you to run and hide! And you'd better take care of your family, if you know what I mean! So, ladies and gentlemen, I'm tellin' ya this right now, if you are of another race of people, we recognize your right to fight for your race, and we consider you a friend. But, if you are one of these people who wants to hurt the white race, then we'll be under you.

"We also are the enemy. When we talk about being enemies of people, we're the enemy of the stinkin', filthy, drug-pusher who pushes his drugs on our children. We're enemies of the stinkin', filthy, homo-sexuals who spread their killer disease, AIDS, around; and we're the enemy of these rich monopoly capitalists who have sold out the white working people for the almighty buck. So, if you want to do something about it, if you're gettin' sick and tired of the way this stinkin' Government of the United States has treated you; then you come join with us, and together we will do plenty about it!

"This is the White Aryan Resistance, P. O. Box 265, Jay, Oklahoma, 74346. Write us, drop in a buck for postage and handling, we'll send ya our newspaper and plenty of literature to get ya started. Hail victory. Leave a brief message at the end of this tape, if you care to."

RECORDED MUSIC (as at the beginning): "Hope you've got your things together. Hope you have practiced every day. Looks like we're in for nasty weather. --------- take us for a ride. Don't fool around tonight. (We're bound to take a ride) ----out the ----on the right."

EXHIBIT #4

TULSA WORLD

Saturday, June 4, 1988

Lenders Race to Foreclose On Farms Before Deadline

By JIM MYERS
World Capitol Bureau

OKLAHOMA CITY — Federal lenders appear to be racing to foreclose on hundreds of farmers across Oklahoma before new regulations take effect next month, a state official said Friday.

Moreover, Assistant Attorney General Janie Sims Hipp said lenders reportedly are violating existing law and farmers' rights in order to beat the deadline and in some cases are forcing some farmers into bankruptcy to save their farms.

Hipp said Attorney General Robert Henry may take the lenders to court.

Ironically, the forthcoming farm credit regulations stem from a new law designed to help protect the family farms from being sold off because of debt problems.

"It appears they are trying to get as many foreclosed on as fast as they can," Hipp said of the farm lenders such as the Farmers Home Administration and the federal land banks.

She said the lenders may be "rushing" to foreclose because of the additional restrictions they will be put under by the new federal regulations.

When contacted for a response, an official with the Farm Credit System in Wichita, Kan., expressed surprise at the attorney general's concerns and has scheduled a meeting with Henry's office next week.

Hipp said Henry became involved in the issue while serving as vice chairman of a committee on agricultural and rural legal affairs for the National Association of Attorneys General.

Lenders, she said, have mailed hundreds of so-called 45-day letters notifying farmers their loans need to be restructured.

She said farmers then have the right to respond with a "preliminary" restructuring plan, which sometimes includes pages of facts and figures specifically detailing their financial status.

"What is suppose to happen next is a restructuring phase," Hipp said.

Instead, she said, lenders are establishing a pattern of denying farmers almost immediately the right to have their loan restructured.

"Some farmers are getting denials four days later," Hipp said.

"It seems to me that it should take longer than that to validly look at it."

She related one of several horror stories in which the farmer traveled 150 miles to a meeting with his lenders that lasted into the evening hours.

"The next morning's mail brought his letter of denial," Hipp said, questioning whether the decision was made and the letter mailed even before the farmer's meeting.

In some cases, she said lenders also have been accused of not allowing farmers a face-to-face meeting, even though such a session is required by law during the farmers' appeal stage.

Once the appeal is denied, lenders are free to initiate a sheriff's sale or foreclosure.

Hipp said some farmers have been forced to file for Chapter 12 bankruptcy protection in order to save their farms.

"A lot of people thought the farm crisis was over a few years ago," she said, relating another horror story of a farm family north of Edmond whose farm was sold out from under them without proper notice.

"These things just can't be allowed to happen."

Echoing those concerns was Max Glenn of the Oklahoma Conference of Churches, which has helped coordinate the AGLINK hotline for farmers.

"The intensity and the number of calls to the hotline continue to increase," Glenn said.

He said the Farmer's Home Ad-

See Lenders Race on A-4

Fast Take

The state attorney general is considering filing suit against federal lenders to prevent them from foreclosing on Oklahoma farmers before new regulations to protect farmers take effect next month. More Fast Takes on A-4.

Lenders Race to Foreclose on Farms

Continued from A-1

ministration put out figures Friday showing $334 million in delinquent farm loans in Oklahoma.

Of that figure, Glenn said, $214 million in loans have been delinquent more than four years.

"But the significant thing is $21 million is one year or less delinquent," he said.

"That means operating funds. That says the crisis is continuing if the current operation funding has that kind of deficit."

Glenn said Oklahoma is seventh in the nation on the list of delinquent farm loans.

He said his group has brought farmers' concerns to lenders' attention and is preparing testimony for hearings scheduled by U.S. Sen. David Boren, D-Okla.

Terry Gutschenritter, vice president of special credit for the Farm Credit System in Wichita, Kan., said he was not aware of massive problems.

"I am surprised," Gutschenritter said of the attorney general's criticism.

"He has not been in contact with me."

He also denied reports that lenders have violated farmers' rights to have face-to-face meetings during their appeal process.

"That is not the case," Gutschenritter said.

"We are operating in compliance with the law today."

In addition, he said the new regulations from the Farm Credit Administration will closely resemble the procedures now in use.

He conceded his office has received some complaints from individual farmers and from Congressional offices but called those "isolated."

Gutschenritter said officials reviewed those cases and determined lenders went beyond what was required by law.

Hipp said Gutschenritter, after speaking with a reporter, called her office and set up the meeting for next week.

Dates, Locations and Times

Monday, March 21

MUSKOGEE

Time: 9 a.m. to 5 p.m.
Place: Indian Capital Area Vo-Tech
Intersection of Highway 69 and 62

Tuesday, March 22

McALESTER

Time: 9 a.m. to 5 p.m.
Place: Kiamichi Area Vo-Tech School
Kiamichi Drive

Wednesday, March 23

LAWTON

Time: 9 a.m. to 5 p.m.
Place: Great Plains Vo-Tech
Lee Boulevard, west. South side of Lee

Thursday, March 24

CLINTON

Time: 9 a.m. to 5 p.m.
Place: Patrick Center
Custer County Fairgrounds, take 183 exit

Friday, March 25

ENID

Time: 9 a.m. to 5 p.m.
Place: Hoover Building
Garfield County Fairgrounds

★★★★★★★★★★★

ALSO

FARM SEMINAR

Saturday, March 26
3 p.m. to 6 p.m.
Guymon High School
Guymon High School Gym
Guymon, Oklahoma

Sponsored by the Tri-County Electric Co-op
and AG-LINK
For more information, contact
Jack L. Perkins (405) 652-2418

★★★★★★★★★★★★★★

AG-LINK Coalition
P.O. Box 60288 Oklahoma City, Oklahoma 73146

Exhibit #5

What the new

FARM CREDIT ACT

can do for
Oklahomans

A series of

OUTREACH WORKSHOPS

Sponsored by the

AG-LINK Coalition

and coordinated by the
Oklahoma Conference of Churches

WHO SHOULD ATTEND?

* Farmers and Ranchers
* Stockholders of FCS
* FCS Association Boards and staff
* FmHA County Committees
* Extension Agents
* IFMAPS and Vo-Tech farm specialists
* Mediators in Oklahoma's Agricultural Mediation Program
* Clergy and other professionals supporting rural families
* Attorneys
* Rural bankers

March 21 to March 26, 1988

(See locations & times inside)

PURPOSE OF WORKSHOPS

1. To help Oklahoma farmers, ranchers, and creditors understand the contents and congressional intent of the new landmark legislation dealing with the Farm Credit System, the Farmers Home Administration, Mediation, and the creation of secondary mortgage markets. This legislation was developed by Congress and signed by President Ronald Reagan on January 6, 1988 – The Agricultural Credit Act of 1987.

2. To examine the new BORROWER's RIGHTS and requirements for both borrowers and creditors to "restructure" debt.

3. To provide information on other tools available for Oklahoma farmers and ranchers such as Mediation, Agricultural Linked Deposit Program administered by the State Treasurer's office, reorganization under Chapter 12 Bankruptcy and secondary mortgage markets, financial planning available from OSU's IFMAPS and Vo-Tech Farm Management, and AG-LINK Hotline resources.

Speakers and resource team members are people who worked closely with Congress to develop legislation which addresses the needs of both farmers and creditors and provides a "Win-Win" solution.

Cost: There is no registration fee, but "the hat" will be passed to cover expenses for the workshop participants.

For further information call Ron Johnson or Max Glenn at 1-800-AG8-LINK.

AGENDA

9:00 a.m.	**Registration**
9:30	**Introduction to Outreach Workshop** Max E. Glenn, Ag-LINK Coordinator Ron W. Johnson, AG-LINK Hotline Consultant
9:45 to 10:15	**Farm Credit provisions, FCS borrower's rights** Cheryl Cook, attorney Washington office, Farmers Union
10:20 to 10:50	**Farmers Home Administration (FmHA) provisions** **FmHA borrower's rights** Joey Schmidt, Farm Project Attorney Legal Aid of Western Oklahoma Lynn Hayes, attorney Farmers Legal Action Group (FLAG) National Save The Family Farm Coalition
10:55 to 11:25	**The Agriculture Credit Act:** **What's in it for farmers and creditors?** Danny Levitas Prairiefire and National Save The Family Farm Coalition
11:30 to 12:00	**Ninth District FCS: Restructuring Policy** Wichita District staff of FCS
12:00 noon	**Lunch** (on your own)
1:15 to 4:00	**Small group discussion** Identify main questions In-depth discussion on FCS and FmHA
4:15 to 5:00	**Summary and response to main questions**

Coalition Member Co-Sponsors:

Oklahoma Farmers Union
Oklahoma Association of Electric Cooperatives
Association of County Commissioners
Farm Task Force of the Okla. Bar Assn.
Legal Aid of Western Oklahoma
Legal Services of Eastern Oklahoma
Agricultural Research and Extension Programs of Langston University
Senate and House Agriculture Committees of the Oklahoma State Legislature
Oklahoma Department of Libraries
American Agriculture Movement of Oklahoma

Additional Co-Sponsors:

Oklahoma Wheat Growers Association
Farm Credit Services
Oklahoma Farm Credit Coalition
Oklahoma Attorney General's Office

EXHIBIT #5

P. O. Box 1814
Stillwater, OK 74076
June 6, 1988

Mr. Terry Gutschenritter
Vice-President of Special Credit
Farm Credit System
Wichita, KA 67200

Dear Mr. Gutschenritter:

After reading the Tulsa World news story on Saturday, June 4, 1988, "Lenders Race To Foreclose on Farms Before Deadline," I decided to contact the Noble County Sheriff Ron McGee today to see if he had anything on my farm land. After checking, he indicated that on May 10, 1988, he had received notification to set a sale on 80 acres which we have a Federal Land Bank loan on in Noble County from the Northcutt Law Firm representing the Federal Land Bank of Ponca City. The sale is scheduled for June 21, 1988, at 10 a.m. in Perry, Oklahoma. Mr. Gutschenritter I have not received any notification of this sale and I have not received the 45-day letter of notification for restructuring of the loan.

This is the second time which this has happened on the same 80 acres of land, the first time in February, 1988, I had to have my attorney file a motion to squash the sale after a relative told me that the land was scheduled for a Sheriff Sale and the administrator of the FLB in Ponca City would not voluntarily cancel the sale.

Will I have to pursue the same legal procedure as before, in order to receive legal due process and the opportunity to restucture the loan? Please advise me on this matter prior to Wednesday, June 15, 1988.

Sincerely,

Fern Green

Fern Green

cc: Attorney General Robert Henry
U. S. Senator David Boren
U. S. Representative Wes Watkins
Max Glenn, OK Conference of Churches
James M. Springer, Attorney
Jim Myers, Tulsa World

Mr. Glenn, you may utilize my FLB case in the hearings set by Senator Boren for June 16 in Washington, DC
F. A. Green

Senator BOREN. Thank you very much, Max, and I appreciate again the very constructive role that you are playing in our State. Do not give up on your efforts. I know sometimes it is discouraging, but do not give up on your efforts, including the mediation effort and the effort to try to get the System to cooperate in terms of educating the farmers as to their rights.

I think what I have heard all four of you say is that thus far a big part of what is needed is real aggressive use of the regulatory authority that is given to the FCA to enforce the letter and the spirit of the law, rather than dragging their feet and being dragged into lawsuits themselves because of failure to enforce it. As has been said, there needs to be a proactive policy adopted there, and I think that I could not agree more. I think it is very crucial that we do it, because I think we basically do have a good law, if they live by the letter and the spirit of it. It will not only save money, it will save a tremendous amount of social upheaval and tragedy if we follow it.

Mr. Strebeck.

STATEMENT OF CLAYTON L. STREBECK, ASSOCIATE AREA AGENT (FARM MANAGEMENT), LOUISIANA COOPERATIVE EXTENSION SERVICE, ALEXANDRIA, LA

Mr. STREBECK. Mr. Chairman, thank you for the opportunity to be here this afternoon.

I am Clayton L. Strebeck, associate area agent (farm management) with the Louisiana Cooperative Extension Service. For the past 3½ years, I have been working directly with farm families who were experiencing financial difficulties that have been discussed here today. I have seen firsthand the actions, pressures, stress, and strain that these people are under.

For 2 years, I had a home economist work with me as an agent team responding to these calls. I worked with approximately 75 families in the last 3½ years. To the best of my knowledge, there is only 1 of these families that has been successful in getting a loan restructured with the land bank.

These farmers get this letter—we refer to it as a 48-day letter, because it says in the letter that you respond 48 days from the date of the letter, it is a 45-day notice, but they allow 3 days for you to get it.

These farmers do not have the knowledge or expertise to fill out and comply with all of the information that is needed to put this restructure plan together. Restructuring debts is a very complicated and involved process, and it is compounded by the number of creditors that these farmers owe. The Federal land bank, being the primary lender, is usually the first one that we talk about. In order for a restructured plan to work, we must have cooperation between lenders. It involves the Farmers Home Administration, commercial banks, Small Business Administration, equipment dealers, farm supply people, and we still do have a few that are doing business with Production Credit.

The restructure plan must be based on cash-flow of the business using factual and realistic information or it will not work.

I have been all the way through a process from taking the information, developing the cash-flow plan, through an appeal hearing. The people that we work with either do not know what they are doing, do not have the authority or will not make decisions, and this makes the process even a greater problem.

On the appraisal of real estate, they are using an in-house appraiser with the land bank or one on a contract basis. They are not taking into consideration the agricultural use value of this land. If a cash-flow statement is going to be developed and be meaningful in working out a restructured plan, it must be accurate, complete, and realistic based on agricultural use value. Any plan of restructuring debt that is developed, where the cash-flow statement is not accurate, will not work. You are going to have payments set that farmers cannot meet.

One other point: In working up these restructured plans, many of our farmers have used their equipment until it is almost past the state of repair. They have not kept it up to date. In order for a restructuring plan to work, there needs to be an allocation of funds for capital purchases. If there is not, we are going to have plans approved and the farmers are not going to be able to get the funds to buy the equipment to keep their farm on a viable basis.

We have lots of farmers who are ready, eager, and anxious to work with their creditors to develop a restructured plan. They want to work and cooperate in order to hold their losses to a minimum. There has been no indications that we are getting this from some of the other people.

The farmers would love to avoid the agony and added expense of bankruptcy. Mr. Chairman, you mentioned a few minutes ago that they had lost control of the System. I happen to have worked in the Farm Credit System for over 17 years. I worked for the Federal Intermediate Credit Bank of New Orleans as a State field supervisor for Louisiana. I was president of Alexandria Production Credit for 7½ years. I have worked with farmers, they are honest, they want to do right.

The Farm Credit Act of 1971 to a large extent stripped the local boards of directors and the presidents or chief executive officers of their management authority. A good example of this is First South Production Credit Association, in Louisiana, Mississippi and Alabama. You have central control in Jackson, Mississippi.

From past experience, it is not possible to extend credit to farmers in the State of Louisiana with a man making decisions in Jackson, Mississippi.

Senator BOREN. That is right.

Mr. STREBECK. I appreciate the opportunity to be here very much. Thank you, sir.

[The prepared statement, with attachments, of Mr. Strebeck follow:]

STATEMENT
CLAYTON L. STREBECK
LOUISIANA COOPERATIVE EXTENSION SERVICE
June 16, 1988

TO: Senate Sub-Committee on Agricultural Credit

Good Morning

Mr. Chairman, members of the Sub-Committee on Agricultural Credit, thank you for the opportunity to appear before this committee.

I am Clayton L. Strebeck, Associate Area Agent (Farm Management) with the Louisiana Cooperative Extension Service. For the past three and one-half years, I have worked with farm families who were experiencing financial difficulties and their lenders in Central Louisiana in my assigned area of Rapides, Grant and Avoyelles Parishes. I have also worked with families outside this area in Concordia, Natchitoches, Sabine, Vernon and St. Landry parishes.

During the first two years, I worked with Mrs. Jane Jones, Home Economist in Grant Parish or Mrs. Callie T. Lemoine, Home Economist in Avoyelles Parish as an "Agent Team" responding to families who contacted the LSU Farm Crisis Hotline seeking assistance with their financial problems.

Approximately seventy-five families in the parishes where I have worked, requested assistance in developing cash flow projections and debt restructure plans to comply with the demands of their lenders. Most farmers do not possess the knowledge and expertise in preparing this type of information. Their problem is magnified by the stress and strain caused by their financial condition. Lenders have not provided any assistance to the farmer in preparing this information.

Only one of these 75 families, to my knowledge, has been successful in developing a restructure plan that was approved by the Federal Land Bank. The process took over one year from beginning until the new legal documents were executed. About the time we thought their problem was solved, a new employee would appear on the scene and we had to go through an extended period of education and negotiation. The plan that was approved was basically the first plan submitted.

Developing a debt restructure plan is a complex and involved process that is compounded by the number of creditors. The plan must be developed based on available cash flow of the business and the proceeds distributed among all creditors. When the Federal Land Bank demands all of the funds that are available for debt service the plan fails with other creditors.

The restructure plan must be developed based on information that is factual and realistic and all creditors must cooperate and work together if losses are to be held to a minimum. There has been no indication of this cooperative effort up to this time by the Land Bank.

Cash flow financing is here to stay, or should be, if farmers are to be successful in the future. Accurate and complete records are a necessity. The farm business must be operated within the income producing ability of that farm.

Working with representatives of Capital Corporation, Special Assets, Large Loan Group, Federal Land Bank or what ever name they are using at the time has been an impossible task. They want all of the funds available for debt service. They have become a collection agency instead of a service agency that works with farmers for the mutual benefit of both parties.

Accompaning a farmer to an appeal hearing with representatives of Capital Corporation was an enlightning experience. They were more concerned with the make automobile of the farmer than the facts in the restructured plan. If was obvious from the beginning his plan would be rejected, and they had nothing positive to contribute.

Trying to determine whether restructure or foreclosure is the least costly has been impossible to date. Employees of the Land Bank do not appear to know what their loss is and they are not willing to discuss it with the farmer. The farmer is not in a position to determine the loss for the Land Bank.

Appraisal of real estate by the Land Bank or their contract appraisers has been based on market value using comparable sales with little or no consideration for agricultural use value. Cash flow is determined based on the agricultural income producing ability of that farm. Any restructure plan that does not take this fact into consideration will not wo[illegible] Income will be insufficient to meet the payments and the farmer[illegible] ll be back in trouble.

The debt restructure plan should include an allocation of funds for capital purchases. Machinery and equipment has not been kept up-to-date in recent years due to the shortfall of cash flow. Each farm is different and must be analyzed and evaluated on an individual basis. Employees have not been willing to discuss this fact.

The right of first refusal is meaningless to some farmers when the Federal Land Bank refuses to provide the financing for the previous owner. When foreclosure is necessary, the Land Bank is requiring the previous owner to pay the Land Bank in full. He must obtain credit from another source and there may not be another source available.

Attempting to work with employees who have little or no authority or will not use the authority granted compounds the farmer's problem. The credit needs of farmers could be served on a more constructive basis if the decision making authority was restored to the local board of directors and management. These individuals are in a better position to know and deal with the problems.

Mr. Chairman, I can assure you these problems are real and I encourage you to enforce the provisions of the law. Many farmers are waiting for the opportunity to work with their creditors to restructure their debts and avoid the agony and added expense of bankruptcy.

Mr. Chairman, I appreciate the opportunity to appear before this committee.

Thank you.

PATRICK J. LEAHY, VERMONT, CHAIRMAN
JOHN MELCHER, MONTANA
DAVID H. PRYOR, ARKANSAS
DAVID L. BOREN, OKLAHOMA
HOWELL HEFLIN, ALABAMA
TOM HARKIN, IOWA
KENT CONRAD, NORTH DAKOTA
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THOMAS A. DASCHLE, SOUTH DAKOTA
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RICHARD G. LUGAR, INDIANA
ROBERT DOLE, KANSAS
JESSE HELMS, NORTH CAROLINA
THAD COCHRAN, MISSISSIPPI
RUDY BOSCHWITZ, MINNESOTA
MITCH McCONNELL, KENTUCKY
CHRISTOPHER S. "KIT" BOND, MISSOURI
PETE WILSON, CALIFORNIA
DAVID K. KARNES, NEBRASKA

United States Senate
COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

July 12, 1988

Mr. Clayton L. Strebeck
Associate Area Agent (Farm Management)
Louisiana Cooperative
Extension Service
3727 Government Street
Suite 105
Alexandria, Louisiana 71302

Dear Mr. Strebeck:

We appreciate your testifying before the Committee on June 16, 1988. Enclosed are additional questions which are being submitted to you for written answers. We would appreciate receiving your answers to the questions by July 29, 1988 so that the hearing record may be printed as soon as possible.

Thank you for your cooperation.

Sincerely,

DAVID L. BOREN
Chairman
Subcommittee on
Agricultural Credit

Questions from Senator Tom Daschle
Hearing on the Implementation of the Agricultural Credit Act of 1987
Senate Agriculture Committee
June 16, 1988

Clayton L. Strebeck, Louisiana Cooperative Service

I have been contacted by many constituents who find it awfully difficult to fill out the restructuring forms, because they are not clear what is actually needed by the System. Are you aware of this problem and can you let me know what you see as the implications of these vague forms?

LOUISIANA
COOPERATIVE
EXTENSION SERVICE
LOUISIANA STATE UNIVERSITY AGRICULTURAL CENTER

CENLA AREA OFFICE
3727 Government Street, Suite 105
Alexandria, LA 71302
318 443-0522

July 25, 1988

Honorable David L. Boren, Chairman
U.S. Senate Subcommittee on Agricultural Credit
Washington, DC 20510-6000

Dear Senator Boren:

Enclosed is the information requested concerning the hearing on the implementation of the Agricultural Credit Act of 1987 held on June 16, 1988.

Please advise if I can be of further assistance.

Sincerely,

Clayton L. Strebeck

Clayton L. Strebeck
Associate Area Agent
Farm Management

cc: Senator John Breaux
Dr. Rouse Caffey
Dr. Denver Loupe
Dr. Leland Scoggins

LOUISIANA COOPERATIVE EXTENSION SERVICE PROVIDES EQUAL OPPORTUNITIES IN PROGRAMS AND EMPLOYMENT. LOUISIANA STATE UNIVERSITY AND A & M COLLEGE, LOUISIANA PARISH GOVERNING BODIES, SOUTHERN UNIVERSITY, AND UNITED STATES DEPARTMENT OF AGRICULTURE COOPERATING

Questions from Senator Tom Daschle
Hearing on the Implementation of the Agricultural Credit Act of 1987
Senate Agriculture Committee
June 16, 1988

Clayton L. Strebeck, Louisiana Cooperative Service

I have been contacted by many constituents who find it awfully difficult to fill out the restructuring forms, because they are not clear what is actually needed by the System. Are you aware of this problem and can you let me know what you see as the implications of these vague forms?

Enclosed is a copy (Exhibit I) of the packet of information the farmer receives from the Federal Land Bank in Receivership that must be completed and returned to them for consideration in restructuring the debt. It is difficult for farmers to complete these forms because they are not accustomed to preparing this type information. Most farmers do not possess the knowledge or experience in credit that is needed to complete these forms and develop a restructure plan for their debt. In the past, this type information was compiled by the lender with the assistance of the farmer. This was during the time they were making loans and not trying to liquidate loans. Farmers are sincere in trying to complete these forms accurately and completely. They consider this restructuring opportunity as the last chance to work with their lender and avoid bankruptcy. These problems are very real.

Much of the information contained in these forms is for the previous three years history. During this time period, the financial position of many farmers has continued to deteriorate due to poor crops, low commodity prices, and declining values of equipment and real estate. The farmers are aware of the contribution these factors have had on their financial situation. The implications of the information contained in this packet of forms is that the land bank can use it to reject any restructure plan and justify foreclosure.

Enclosed is a copy (Exhibit II) of the Cost of Restructure Worksheet and the Cost of Foreclosure Worksheet, that is used by the Federal Land Bank in Receivership to determine which is the best way for them to proceed. I have not seen these forms completed and they are not sent to the farmer. There are many vague variables included on the forms. A set of instructions would be a requirement before these forms could be completed.

Enclosed is a copy, (Exhibit III) of a letter to a farmer advising of committee action and a printed form of "Principal Reason(s) For Credit Committee Decision" listing the reasons for the action on his restructure plan. This farmer had his restructure plan. This farmer had his restructure plan rejected, appealed their decision and lost the appeal. There are reasons listed on this form to justify declining almost any proposed restructure plan.

EXHIBIT I

Federal Land Bank of Jackson
and
Federal Land Bank Association of Jackson
IN RECEIVERSHIP

ALEXANDRIA BRANCH
7312 South McArthur
P. O. Box 5918
Alexandria, LA 71307
318-487-4336

CERTIFIED RETURN RECEIPT REQUESTED

June 1988

Re: Federal Land Bank Loan No.

Dear Mr.

The above referenced loan is in default. This is to inform you that the Federal Land Bank of Jackson intends to initiate foreclosure on the loan on or after the forty-eighth (48th) day following the date of this letter unless an acceptable restructuring plan is submitted.

Enclosed is a copy of the Federal Land Bank of Jackson's Distressed Loan Restructuring Policy which has been adopted by the board of directors, and restructuring application. You may be eligible for distressed loan restructuring consideration under this policy.

SHOULD YOU DECIDE TO SEEK DISTRESSED LOAN RESTRUCTURING, YOU MUST COMPLETE AND EXECUTE THE RESTRUCTURING APPLICATION AND SUBMIT IT TO THIS OFFICE, TOGETHER WITH THE OTHER DOCUMENTS AND INFORMATION REQUESTED NO LATER THAN THE END OF THE BUSINESS DAY ON THE FORTY-EIGHTH (48TH) DAY FOLLOWING THE DATE OF THIS LETTER. IT IS THE BANK'S POLICY NOT TO CONSIDER RESTRUCTURING APPLICATIONS SUBMITTED AFTER THIS TIME PERIOD AND FORECLOSURE OR OTHER APPROPRIATE COLLECTION PROCEEDINGS MAY BE INITIATED.

I would like to meet with you to review the status of your loan and discuss the application procedures and suitable restructuring alternatives. Please contact me at your earliest convenience to arrange a mutually convenient time.

June , 1988
RE: FLB #

Please note that copies of this letter, together with copies of the restructuring application and the restructuring policy, are being provided to all other obligors and guarantors (if applicable) on the loan.

Sincerely,

Loan Officer

enclosures

cc:

BOARD POLICY OF THE FIFTH DISTRICT FARM CREDIT BANKS AND FLBA OF JACKSON AND FIRST SOUTH PCA	SECTION DISTRESSED LOAN RESTRUCTURING SUBJECT

SUMMARY:

The following sets forth the restructuring policy of the Fifth Farm Credit District. This policy governs the restructuring of distressed loans made by qualified lenders (lenders), as defined below, and their successors.

All lenders in the district have an obligation to borrowers, stockholders, and investors in System debt obligations to collect all debts owed to the lender. Borrowers are expected to comply with contractual loan terms and conditions. In those instances where a district lender determines that the borrower's loan is a distressed loan, the lender shall consider restructuring in accordance with this policy. (NOTE: This policy does not apply to loans made by the Jackson Bank for Cooperatives.

DEFINITIONS:

QUALIFIED LENDER is:

- an institution of the Farm Credit System that makes loans (such as the term loan, as defined), excluding the Jackson Bank for Cooperatives, and
- other financing institutions (OFI), as defined in Section 2.3(a)(2) of the Farm Credit Act of 1971, as amended, but only with respect to loans discounted or pledged by an OFI to the Federal Intermediate Credit Bank of Jackson (FICB), or the FICB's successor, should the FICB merge with another bank.

LOAN -- A loan made to a farmer, rancher, or producer or harvester of aquatic products for an agricultural or aquatic purpose and other credit needs of the borrower. This includes financing for basic processing and marketing directly related to the borrower's operations and those of other eligible farmers, ranchers, producers or harvesters of aquatic products.

DISTRESSED LOAN refers to a loan:

- where the borrower does not have the financial capacity to pay according to the loan terms, and
- that exhibits one or more of the following characteristics:
  - The borrower is demonstrating adverse financial and repayment trends.
  - The loan is delinquent or past due under the terms of the loan contract.

EFFECTIVE DATE
February 17, 1988

- One or both of the factors listed above, together with inadequate collateralization, present a high probability of loss to the lender.

RESTRUCTURING includes rescheduling, reamortization, renewal, deferral of principal or interest, monetary concessions, and any other action to modify the terms of, or forbear on, a distressed loan in any way that will make it probable that the operations of the borrower will become financially viable.

APPLICATION FOR RESTRUCTURING is a written request from a borrower for the restructuring of a distressed loan in accordance with a preliminary restructuring plan proposed by the borrower as part of the application. The application must be submitted on appropriate forms prescribed by the lender. The application must be accompanied by sufficient financial information and repayment projections as required by the lender to support a sound credit decision.

COST OF RESTRUCTURING -- In determining whether the potential cost to the lender of restructuring a distressed loan is less than or equal to the potential cost of foreclosure, the lender shall consider the following points.

- Present value of interest income and principal foregone by the lender in carrying out the restructuring plan.

- Reasonable and necessary administrative expenses involved in working with the borrower to finalize and implement the restructuring plan, including attorneys' fees, costs, and other expenses advanced by the lender pursuant to the loan documents.

- Whether the borrower has presented a preliminary restructuring plan and cash flow analysis. The plan must take into account income from all sources to be applied to the debt and all assets to be pledged, and show a reasonable probability that orderly debt retirement will occur as a result of the proposed restructuring.

- Whether the borrower has furnished or is willing to furnish complete and current financial statements in a form acceptable to the lender.

- Any other factors considered relevant by the lender that bear upon the individual restructuring decision. The factors may include, but are not limited to, the following.

- whether the borrower is applying all income over and above necessary and reasonable living and operating expenses to the payment of primary obligations;

- whether the borrower has the financial capacity and the management skills to protect the collateral from diversion, dissipation, or deterioration;

- whether the borrower is capable of working out existing financial difficulties, reestablishing a viable operation, and repaying the loan on a rescheduled basis; and

- in the case of a distr .ssed loan that is not delinquent, whether restructuring consistent with sound lending practices may be taken to reasonably ensure that the loan will not become a non-accrual loan.

FORECLOSURE PROCEEDING may be one of the following.

- A foreclosure or similar legal proceeding to enforce a lien on property, whether real or personal, that secures a nonaccrual or distressed loan.

- The seizing of and realizing on nonreal property collateral other than stock, participation certificates allocated surplus, or investments in equity reserve in a Farm Credit System institution.

COST OF FORECLOSURE is composed of these amounts:

- The difference between the outstanding balance due on a loan made by a lender and the loan's liquidation value. Consider the borrower's repayment capacity and the liquidation value of the collateral used to secure the loan.

- The estimated cost of maintaining a loan as a nonperforming asset.

- The estimated cost of administrative and legal actions necessary to foreclose a loan and dispose of property acquired as the result of the foreclosure, including attorneys' fees and court costs.

- The estimated cost of changes in the value of the collateral used to secure a loan from the time action is initiated to foreclose or liquidate until the disposal of the collateral.

- All other costs incurred as the result of the foreclosure or liquidation of a loan.

SECTION	SUBJECT
DISTRESSED LOAN RESTRUCTURING	

RESTRUCTURING CRITERIA:

LEAST COST TO LENDER -- When a lender receives an application for restructuring from a borrower and the lender determines that the loan is a distressed loan, the lender shall determine whether or not to restructure the loan. The potential cost of restructuring the loan and the potential cost of foreclosure must be considered. If a lender determines that the potential cost to the lender of restructuring the loan in accordance with a proposed restructuring plan is less than or equal to the potential cost of foreclosure, the lender shall restructure the loan in accordance with the plan. Cost includes all factors relevant to making a sound credit decision.

APPLICATION SUBMITTAL -- A lender is not required to consider a distressed loan for restructuring unless the borrower submits an application for restructuring.

LENDER-PROPOSED PLANS -- This policy shall not prevent a lender from proposing a restructuring plan for a borrower, but the lender is under no obligation to do so. If two or more restructuring alternatives are available, one or more of which may have been proposed by the lender, the lender shall restructure the loan in conformity with the alternative that results in the least cost to the lender.

PREVENTIVE ACTIONS:

COLLATERAL PROTECTION -- Nothing contained in this policy shall be construed to prevent any lender from enforcing any contractual provisions that allow the lender to foreclose a loan, or from taking other lawful action the lender deems appropriate, if the lender has reasonable grounds to believe that the loan collateral will be destroyed, dissipated, consumed, spent, concealed, or permanently removed from the state in which the collateral is located.

MEETINGS:

REASONABLE OPPORTUNITY -- On determination by a lender that a loan is or has become a distressed loan, the lender shall provide a reasonable opportunity for the borrower to personally meet with a representative to review:

- the status of the loan,
- the financial condition of the borrower, and
- the suitability of the loan for restructuring.

NONACCRUAL LOAN -- For a loan in nonaccrual status, the borrower may meet with the lender to develop a plan for restructuring the loan, if the loan is suitable for restructuring.

SECTION	SUBJECT
DISTRESSED LOAN RESTRUCTURING	

NOTICE TO BORROWERS:

IN GENERAL -- On determination by a lender that a loan is or has become a distressed loan, the lender shall provide written notice to the borrower that the loan may be suitable for restructuring. The written notice must include a copy of this policy and an application form.

LOANS IN DEFAULT -- No later than 45 days before an institution begins foreclosure proceedings, the lender shall provide written notice to the borrower that the loan may be suitable for restructuring. This written notice must include:

- a copy of this restructuring policy; and
- the appropriate forms necessary to enable the borrower to submit an application for restructuring the loan.

APPLICATION PROCEDURES:

45 DAY LIMIT -- Any borrower who has been notified that their loan may be suitable for restructuring may submit an application for restructuring. To be considered, an application must be received in accordance with the time period set by the lender. The time period set by the lender should not be less than 45 days from the date of the lender's first notice to the borrower that the loan may be suitable for restructuring, plus an additional three days if the notice is mailed.

If an application is not received by the lender within the set time period, the lender may begin foreclosure proceedings. The lender will be under no obligation to consider an application after foreclosure proceedings have commenced.

NOTICE OF DECISION:

PROMPT WRITTEN NOTICE -- The borrower's application for restructuring shall be processed and acted upon expeditiously in conformance with normal loan processing procedures. Upon taking action on an application for restructuring, the lender shall provide prompt written notice of its decision to the borrower, including the terms and conditions of the restructuring if approved, or the reasons for the denial if not approved. The notice shall also advise the borrower of the right to receive a review.

REVIEW:

WRITTEN REQUEST -- A borrower who has received a notice of a decision to deny an application for restructuring a distressed loan may request a review of the decision by the appropriate credit review committee.

92-681 O - 89 - 18

A request for review must be made in writing and received within 7 days (plus an additional 3 days if the lender's notice of denial is mailed) of the date of the lender's written notice of its denial of restructuring.

COUNSEL/REPRESENTATION -- The borrower may appear in person before the credit review committee. The borrower may be accompanied by counsel, or another representative of the borrower's choice, to seek a reversal of the decision on the application under review.

DOCUMENTATION -- The borrower may submit relevant documents or other information to support the information in the restructuring application. Review by the credit review committee will be limited to the application, as supplemented by relevant documents or evidence supporting the information contained in the application. Documents or evidence containing new information that was not mentioned in the application may not be submitted by the applicant and will not be considered by the credit review committee in reviewing the application for restructuring.

INDEPENDENT APPRAISAL -- If a lender required additional collateral as a condition to restructuring the loan, and the application for restructuring was denied because the borrower was not able or willing to provide additional collateral, a request for review filed with the credit review committee may include a request for an independent appraisal by an accredited appraiser.

The credit review committee shall furnish the borrower with a list of three appraisers approved by the lender from which the borrower shall select an appraiser to conduct the appraisal. The cost of the appraisal shall be borne by the borrower. The result of this appraisal shall be considered in the final determination. A copy of the appraisal shall be provided to the borrower and the credit review committee prior to the credit review committee meeting.

FINAL DECISION -- The credit review committee shall reach a decision on the application for restructuring in its sole discretion and the decision shall be final. The credit review committee shall promptly notify the borrower in writing of the committee's decision and of the reasons therefore.

BORROWER STOCK:

If a member's loan is forgiven and any of the principal outstanding written off, the same dollar amount of stock held by the member shall be canceled and retired. However, the member shall be entitled to retain at least one share of stock to maintain membership and a voting interest.

INFORMATION REQUIREMENTS for RESTRUCTURING DISTRESSED LOANS

For the lender to consider restructuring a distressed loan, the following will be required:

- A formal request for restructuring by a borrower on the distressed loan restructuring application.
- Complete and current balance sheets, signed and dated, on all parties liable on the loan(s).
  - With verification of major assets listed on each balance sheet, and supporting balance sheets on any other business owned.
- Fiscal year-end balance sheets for the previous three years.
  - Supporting balance sheets on any other businesses owned fiscal year-end.
- Detailed fiscal year-end income and expense statements for the previous three years. Include:
  - income from all non-farm sources, individual and business;
  - income from any farm-related business; and
  - copies of tax records.
- Detailed acreage and production records for each crop planted for the previous three years. Separate by acreage owned, cash rented or crop share arrangements. Livestock operations should show number of head and production per head.
- A written plan proposed by the borrower which details the adjustments to be made in the farm operation. This plan must include:
  - The specific request being made of the lender.
  - A list of all creditors showing the debt service requirements and interest rates, as well as sources of income for repayment in accordance with the proposed plan. A cash flow analysis to support the presentation must also be submitted.

FIGURE 26
PAGE 1 OF

- A detailed identification of proposed debt restructuring, payment deferrals of interest and/or principal, or compromise of debts presently owned. Specific identification of all concessions being made by each creditor should be provided.

- Detailed acreage and projected yields for each crop planted for the current year, separated by acreage owned, cash rented or crop share arrangements. Livestock operations should show number of head and production per head.

- Projected income and expenses for the current year.

- If the proposed plan calls for changes in crop/production schedules for future years, a detailed projected income and expense statement as well as projected acreage and yields for each crop planted must be provided.

- If payments are delinquent to any major creditors, including the Farm Credit lender, a proposed method for making delinquent payments must be provided.

- A schedule of collateral to be provided to all creditors after the completion of the proposed plan.

- If it is necessary to liquidate assets to accomplish the proposed plan, provide a detailed description of these assets, the intended method of liquidation, and projected time frame to complete anticipated liquidation.

- If the disposal of any real and/or personal property assets does not fully liquidate mortgages on the property, a complete plan for handling the deficiency should be provided.

- A balance sheet that reflects the borrower's financial situation after all adjustments are made according to the proposed plan.

FIGURE 76
PAGE 2 OF 2

DISTRESSED LOAN RESTRUCTURING APPLICATION

A. Identification

FLBA/PCA _____ Applicant(s) _____ SSN# _____ Spouse _____

State _____ _____ _____ _____

County/Parish _____ _____ _____ _____

Branch Office _____ Guarantor(s) _____ _____ _____

_____ Code

Billing Address _____ _____ City State Zip Code Phone _____ Home _____ Work

B. Loan Type

FLB: _____ Farm _____ Rural Residence _____ Other

PCA: a. _____ Livestock _____ Crop _____ Aquatic _____ Rural Residence _____ Other
b. _____ Operating _____ Term _____ Other

C. Monetary Concessions

This application for distressed loan restructuring ☐ does ☐ does not include a request to write-off and forgive principal and/or interest or to reduce the existing contract rate of interest.

D. Type of Restructuring Requested

1. Request is made to extend:

$_____ of $_____ due _____ on loan # _____ until _____
$_____ of $_____ due _____ on loan # _____ until _____
$_____ of $_____ due _____ on loan # _____ until _____
$_____ of $_____ due _____ on loan # _____ until _____

2. Request for Change of Maturity Date:

Aggregate Unpaid Principal	Loan Number	Interest Rate Plan (Level/Decreasing)	Installment Period (Mo., Qtr., A)	New Installment Date(s)
$_____	#_____	_____	_____	_____
$_____	#_____	_____	_____	_____
$_____	#_____	_____	_____	_____
$_____	#_____	_____	_____	_____

3. Request for Deferment of Principal:

Principal Payment Due	Due Date	Defer to Date
$_____	_____	_____
$_____	_____	_____
$_____	_____	_____
$_____	_____	_____

FCS-42 2/90

4. Request for Reamortization:

a. Decreasing Payment Plan

It is requested that said aggregate unpaid amount, including interest accrued thereon, be reamortized at the variable _____ loan rate according to the decreasing repayment plan, the first payment of interest being due and payable on the 1st day of _____, 19____, the principal portion of said indebtedness being due and payable on a _____ year schedule in _____ consecutive _____ installments, the last of which shall include remaining principal with interest, the first being due and payable on the 1st day of _____, 19____.

b. Level Payment Plan

It is requested that said aggregate unpaid amount, including interest accrued thereon, is reamortized at the _____ rate according to the even repayment plan, principal and interest being computed on a _____ year schedule and being due and payable in _____ consecutive _____ installments, the last to include remaining principal and interest; the first installment being due and payable on the 1st day of _____, 19____.

The applicant(s) agree that should the request for reamortization be approved, the rate of interest charged may, if a variable rate obligation, be adjusted from time to time as provided on the Note evidencing this obligation.

In the event the loan requested to be reamortized hereby is payable in monthly installments, it is agreed that if the application is approved the interest which accrues between the date hereof and 30 days prior to the date of the next installment due hereon shall be added to and constitute a part of the aggregate unpaid amount and shall be amortized over the remaining term of the loan and bear interest at the rate provided.

5. Other Restructuring Requested: (Specify) _____

E. Reasons for Requesting Distressed Loan Restructuring:

F. Plan to Retire Debt or Return Loan to Performing Status Including Source of Payment:

G. Additional Collateral Offered as Security (Including Guarantors):

H. Are all Borrowers, Co-Makers, and Guarantors Willing to Acknowledge Their Continued Liability on the Loan if the Restructuring Action is Taken? Explain:

I. Have you Requested that Any of Your Other Creditors Engage in Some Type of Restructuring Action? Explain:

J. Is Restructuring on the Part of Your Other Creditors Necessary in Order to Carry Out the Plan Described in Paragraph F Above?

K. Do you Anticipate an Extension of Additional Credit From Any Other Lender in Order to Carry Out the Plan Described in Paragraph F Above?

Yes _____ No _____ Explain: _____

L. What Will be the Source, Terms and Conditions of Your Operating Credit During the Restructuring Period? Explain:

M. Will You Agree to Provide Fiscal Year-End Financial Information During the Restructuring Period? Explain:

N. Supplemental Data

In order for this Distressed Loan Restructuring Request to be considered, the following supplemental data must be submitted with this application:

_____ Information Requirements for Distressed Loan Restructuring (See Attachment)
_____ Other _____

O. Incomplete Applications

This application will not be considered unless all of the required information is provided, including any supplemental data requested.

B. Release of Information

As authorized by Federal regulations, this association will make available to any other Farm Credit Institution, for its confidential use, any information concerning your loan and this distressed loan restructuring application, including financial statements, your credit history and transactions with this association. Federal regulations also permit this association to furnish any reliable organization impersonal information based solely on transactions or experience the association has had with you.

C. Default Rate

I/We hereby acknowledge that the lender may, as a condition of approval of this application for distressed loan restructuring, require an increase in the default rate of interest.

R. Certification and Acknowledgement

I hereby certify that the foregoing information and the information contained in the Supplemental Data submitted herewith is true and complete to the best of my knowledge and is given for the purpose of obtaining the restructuring action requested herein.

S. Restructuring Agreement

I/We hereby agree that this application, upon the approval hereof, by the Association and/or if required Bank shall constitute an agreement by the applicant(s) to meet the terms of the agreed upon restructuring request, and of their existing obligation to the full extent of the Note(s), Security Agreement(s), Pledge Agreement(s), Mortgage(s), and any other agreement or understanding between the applicant(s) and the Association/Bank, except as amended herein by the restructuring granted. The applicant(s) further agree that the Association/Bank may require the execution of other documents or agreements to fully bind the applicant to any of the terms of restructuring that may hereinafter be approved by the Association/Bank as otherwise required to meet the terms and security requirements of the granted restructuring. Recourse is expressly reserved by the Bank against all persons not parties to this instrument who are or may become liable in any capacity for the repayment of the indebtedness(es) claimed.

Witness _____ Applicant _____ Applicant _____

Dated _____ 19 ____ Applicant _____ Applicant _____

For Association Use

Date Application Received ..... _____

For Bank Use Only

Received in Bank ..... _____

FCB-10
Rev. 2-84

FINANCIAL STATEMENT

Loan No.

Statement of As of 19

ASSETS (ROUND $) LIABILITIES (ROUND $)

Column 1	APPLICANT Column 2 Amount at Application	FOR ASSN. USE Column 3 Adjusted at Loan Closing	Column 4 To Whom Payable Security Given and Date Incurred	Col. 5 Interest Rate	Col. 6 Annual $ Payment	APPLICANT Column 7 Amount at Application	FOR ASSN. USE Column 8 Adjusted at Loan Closing
CURRENT							
Cash on hand and in banks			Notes and Contracts due within 1 year				
Cash value life insurance							
Securities*							
Accounts receivable*							
Notes receivable*							
Products for feed and seed							
Farm products for sale							
Unharvested crops, matured							
Investment Other Crops							
Livestock held for sale:			Crop Loans:				
No. Kind							
No. Kind							
TOTAL CURRENT $			TOTAL CURRENT			$	
INTERMEDIATE							
Stock in cooperatives			Unmatured Debts due in 1 to 7 years from above date				
Automobiles and trucks							
Machinery and equipment							
Breeding livestock:							
No. Kind							
No. Kind							
TOTAL INTERMEDIATE $			TOTAL INTERMEDIATE			$	
FIXED							
Market value of this property			Liens on this property:				
Other real estate:							
Acres or Kind / Location / Yr. Acq.							
			Other real estate liens:				
Sales contracts receivable							
Terms							
TOTAL FIXED $			TOTAL LONG TERM			$	
TOTAL ASSETS $			TOTAL LIABILITIES			$	
Intangible assets $			NET WORTH			$	
Describe			Contingent liabilities			$	
Current Ratio %							
Liability to asset ratio %			Describe				

FCB-111
REV. 9-87

SUPPORTING SCHEDULES

Notes and Accounts Receivable*

Type	From Whom	Collateral	Interest Rate	Final Date Due	Annual Payment	Present Balance
					$	$
					TOTAL	$

Securities*

Description	Marketable	Not Readily Marketable	Pledged To	Amount Owed
	$	$		$
TOTAL	$	$		

Other: (Indicate whether Asset or (Liability))

Description	Amount	Description	Amount
	$		$
		TOTAL	$

CREDIT-REFERENCES

INCOME—You are not required to disclose income from alimony, child support or maintenance. If you choose to disclose such information, it will be considered in loan evaluation.

EMPLOYEE	EMPLOYER (Name and Address)	JOB DESCRIPTION	YRS. SVC.	GROSS INCOME
				$
				$
			OVERTIME	$

Land to be included in this mortgage — Acres Tillable_____ Acres Pasture_____

Other land owned — Acres Tillable_____ Acres Pasture_____

Land rented from others — Acres Tillable_____ Acres Pasture_____

ESTIMATED FARM INCOME — GROSS $_____ NET $_____

INCOME FROM OTHER SOURCES_____ GROSS $_____ NET $_____

CHECKING ACCOUNT NUMBER_____ SAVINGS ACCOUNT NUMBER_____

PERSONAL STATEMENT: Married ☐ Unmarried ☐ Separated ☐ Child support paid $_____

Amount of alimony paid $_____ Separate Maintenance paid $_____

Applicant's age_____ Spouse's age_____ Children's ages_____

Disabilities (by age or other)_____ Years farmed_____ On this farm_____ yr

How will farm be operated?_____

My principal residence is_____ Which is_____ Miles from this farm

I (we) will ☐ I (we) will not ☐ live on this property.

The information contained in this statement and all other documents referred to herein are true, correct and complete and I (we) fully understand that it is a federal crime punishable by fine or imprisonment, or both, to knowingly make any false statements concerning any of the above facts as applicable under the provisions of Title 18, United States Code, Section 1014.

– Recertified –

Signature_____ Signature_____

Date_____ Date_____

F 555
FCB-101
Rev 8/87

TREND ANALYSIS STATEMENT
INCOME AND EXPENSE

Applicant _____, FLBA _____

	19____			19____			19____		
	ACRES			ACRES			ACRES		
LAND USE	OWNED	RENTED		OWNED	RENTED		OWNED	RENTED	
1. Cropland									
2. Pasture									
3. Timber									
4.									
5. Total Acres									
CROP & LIVESTOCK	ACRES/ UNITS	YLD. PER AC./UT.	GROSS SALES	ACRES/ UNITS	YLD. PER AC./UT.	GROSS SALES	ACRES/ UNITS	YLD. PER AC./UT.	GROSS SALES
1.									
2.									
3.									
4.									
GROSS FARM INCOME									
FARM EXPENSES									
1. Hired Labor									
2. Repairs									
3. Purchased Feeder Stock									
4. Feed									
5. Seed & Plants									
6. Fertilizer									
7. Machinery Hire									
8. Supplies									
9. Livestock Expense									
10. Fuel & Oil									
11. Storage & Transportation									
12. Chemicals									
13. Taxes (R.E. & Pers. Prop.)									
14. Insurance									
15. Utilities									
16. Miscellaneous									
17.									
18. Total Direct Farm Expense									
19. Rents & Leases									
20. Depreciation									
21. Production Interest									
22. All Other Interest									
23. Total Farm Expense	$			$			$		
24. Net Farm Income	$			$			$		
25. Total Farm Cash Flow	$			$			$		
NON-FARM INCOME (List)									
26.									
27.									
28.									
29.									
30. Total Non-Farm Income	$			$			$		

F-554

TREND ANALYSIS STATEMENT
FINANCIAL CONDITION

Applicant _____, FLBA _____

Assets	19___	19___	19___	(+ or −) CHANGE
Cash on hand and in banks				
Cash value life insurance				
Securities				
Accounts Receivable				
Notes receivable				
Products for feed and seed ...				
Farm products for sale				
Unharvested crops, matured ...				
Cash investment in other crops				
Livestock held for sale:				
No.____ Kind_____				
No.____ Kind_____				
Total Current				
Stock in cooperatives				
Automobiles and trucks				
Machinery and equipment				
Breeding livestock:				
No.____ Kind_____				
No.____ Kind_____				
Other				
Total Intermediate				
Market value of this property				
Other Real Estate:				
Acres or Kind / Location / Yr. Acq.				
.....				
.....				
Total Fixed Assets				
Total Assets				
Liabilities				
Notes and contracts due within 1 year				
Crop loans				
Total Current				
Unmatured debts due in 1 to 7 years				
Total Intermediate				
Liens on this property				
Other real estate liens				
Total Long Term				
Total Liabilities				
Net Worth				
Liability to asset ratio	$	$	$	$

Date _____

OBLIGATION TO PROVIDE FUTURE FINANCIAL INFORMATION

I/we, the borrower(s) under FLB/PCA Loan Number _____, hereby agree and covenant to provide verifiable financial statements, including balance sheets and income statements, at least annually to the lender handling my/our loan. I/we agree to provide such information in compliance with a request by the lender and/or under the terms of my/our mortgage/deed of trust.

_____ BORROWER	_____ BORROWER
_____ BORROWER	_____ BORROWER
_____ BORROWER	_____ BORROWER

FCB-43
3/88

FIGURE 25
PAGE 1 OF 1

CREDIT & EMPLOYMENT INFORMATION

Your Name _____ Address _____

Spouse's Name _____ Address _____

Other Business Names _____ Address _____

Social Security Numbers: (yours) _____ (spouse) _____

Telephone Numbers: (Home) _____ (Work) _____

IF EXTRA SPACE IS NEEDED, PLEASE ATTACH AN EXTRA SHEET

I. CREDIT INFORMATION: Show the name, address, and account number (if known) for each financial institution you presently do business with, either as a borrower or as a checking/savings customer.

	Company Name	Address	Type Account	Account #
1.				
2.				
3.				
4.				
5.				
6.				
7.				
8.				

II. EMPLOYMENT INFORMATION:

1. Place of Employment (yours): _____

   Address: _____

   Salary: $_____ per _____: (Bonus, Overtime, etc.) $_____

2. Place of Employment (spouse): _____

   Address: _____

   Salary: $_____per_____: (Bonus, Overtime, etc.) $_____

III. Other: Provide verification of other income: Social Security, Retirement, etc.

FCB-147
Rev. 3/88

Return to:
Federal Land Bank of Jackson
Special Credit
P.O. Box 5918
Alexandria, LA 71307
(318) 487-4336

TO:

I am applying for a loan/loan treatment with the Federal Land Bank of Jackson. I hereby authorize you to furnish employment information. I understand this information will be provided as a business courtesy and will be confidential between you and this institution.

Please complete this form and forward it to them. Your prompt attention will be appreciated.

_____ _____
Signature Date

Name: _____

Address: _____

_____

Soc. Sec. No.: _____

Name and address of above party as they appear on our records.

_____

_____

He/She is _____ is not _____ currently employed by us.

If yes, date employed _____

Present position: _____

Probability of future employment: _____

Gross Salary: _____ per _____

Salary last 12 months: _____

_____ _____
Signature Title

_____
Company

FCB-107

Federal Land Bank of Jackson
Special Credit
P.O. Box 5918
Alexandria, LA 71307
(318) 487-4336

DEBT VERIFICATION AUTHORIZATION

TO:

I applying for a loan/loan treatment with the Federal Land Bank of Jackson. I hereby authorize you to furnish credit information and/or verification of assets or liabilities. I understand that this information will be provided as a business courtesy and will be confidential between you and this institution.

Signature _____ Date _____

Name: _____

Address: _____

_____

Soc Sec No.: _____

****

PLEASE GIVE SPECIFIC BALANCES

Checking Acct(s)		Savings Acct(s)		Other		
Acct No.	Amt	Acct No.	Amt	Type	Acct No.	Amt

LOAN INFORMATION:

Loan No.	Original Principal Balance	Present Principal Balance	Regular Instalmnt	Date Due	Int. Rate	Accd. Int.	Amt of Delqny

OTHER:

Has this individual paid his/her installment satisfactorily ( ) Yes ( ) No

As a credit risk, is this individual considered ( ) Excellent ( ) Good ( ) Fair ( ) Poor

Signature _____ Title _____

Company _____ Phone _____

FCB-108

EXHIBIT II

COST OF RESTRUCTURE WORKSHEET

BASIC DATA:
Cost of funds (0.0000) _____
Principal balance (including stock)* _____

*Remaining after any immediate principal payments

CASH INFLOWS:	Year 1	Year 2	Year 3	Year 4	Year 5
Payments per restructure plan					
App. value of property transferred to bank					
Less distressed sales allowance					
Less prior liens (balance at time of sale)					
Less decrease in collateral value					
Subtotal					
Misc. income					
Misc. income					
Total Cash Inflows					

CASH OUTFLOWS:
Estimated costs - property to be transferred:
Payments on prior liens
Delinquent taxes and taxes due
Maintenance and insurance costs
Attorney's fees, court costs, etc.
Commissions and other selling costs
Misc. other costs
Other funds advanced
Subtotal ("hard costs") _____
Cost of funds to bank/association _____
Total Cash Outflows

SUMMARY OF INVESTMENT:
Investment at beginning of period
Addition to (reduction in) investment
Investment at end of period _____

COST OF RESTRUCTURE:	Cash In	Cash Out	Net Cash Flow
Year 1			
Year 2			
Year 3			
Year 4			
Year 5			

Present value - net cash flows
Total debt less stock (current status)*
Cost of Restructure

Loan bal. at end of restructure period:
AV less sales costs, prior liens, misc. _____
If loan > AV, loan less AV =

*Remaining after any immediate payments (enter negative number)

COST OF FORECLOSURE WORKSHEET

BASIC DATA:
Cost of funds (0.0000)
Principal balance (including stock)*
*Remaining after any immediate principal payments

CASH INFLOWS:	Year 1	Year 2	Year 3	Year 4	Year 5
Appraised value of collateral					
Less distressed sales allowance					
Less prior liens balance at time of sale					
Less decreases in collateral value					
Subtotal					
Misc. income					
Misc. income					
Total Cash Inflows					

CASH OUTFLOWS:					
Estimated costs - existing collateral:					
Payments on prior liens					
Delinquent taxes and taxes due					
Maintenance and insurance costs					
Attorney's fees, court costs, etc.					
Commissions and other selling costs					
Misc. other costs					
Other funds advanced					
Subtotal ("hard costs")					
Cost of funds to bank/association					
Total Cash Outflows					

SUMMARY OF INVESTMENT:					
Investment at beginning of period					
Addition to (reduction in) investment					
Investment at end of period					

COST OF FORECLOSURE:	Cash In	Cash Out	Net Cash Flow
Year 1			
Year 2			
Year 3			
Year 4			
Year 5			

Present value - net cash flows
Total debt less stock (current status)*
Cost of Foreclosure

*Remaining after any immediate payments (enter negative number)

EXHIBIT III

Federal Land Bank of Jackson
and
Federal Land Bank Association of Jackson
IN RECEIVERSHIP

P.O. Box 14167
Jackson, MS 39236-4167
(601) 957-4000

Ju 88

Mr.

Dear Mr.

As a result of our review of the adverse action of Federal Land Bank of Jackson, in Receivership, please be advised that the committee concurs with the adverse decision of the loan officer on your Distressed Loan Restructuring Application.

Please note that this in no way precludes you from further negotiations with the loan officer should you feel you have other alternatives to offer regarding your loan and the loan officer feels that it is in the best interest of the FLB to continue these negotiations.

This decision by the committee is final.

Sincerely,

Chairman

Chairman

TO: (Applicant(s))

Name(s) _____

Address _____

_____

Loan Number _____

FROM: Credit Review Committee

Name Federal Land Bank in Receivership
(Institution)

Address P. O. Box 14167

Jackson, MS 39236-4167

PRINCIPAL REASON(S) FOR CREDIT REVIEW COMMITTEE DECISION

___ Ineligible borrower defined by the Farm Credit Act of 1971, as amended
___ Loan application incomplete
___ Insufficient credit references
___ Unable to verify credit references
___ Records are inadequate for determining loan repayment projections
X Earnings history does not support projections
___ Insufficient income
___ Unable to verify income
___ Probable continuance of income is questionable
___ Excessive obligations
___ Inadequate collateral
___ Delinquent credit obligations
___ Garnishment, attachments, foreclosure, repossession
___ Bankruptcy

___ No credit file
___ Insufficient credit file
___ Unemployed
___ Temporary or irregular employment
___ Unable to verify employment
___ Length of employment
___ Lack of management experience
___ Past management experience below creditor's standards
___ Inadequate management experience
___ Too short a period of residence
___ Unable to verify residence
___ Temporary residence
___ We do not grant credit to any applicant on the terms and conditions that you have requested
X Other (specify): Feasibility

COMMENTS: _____

_____ Chairman, Credit Review Committee

_____ Date

FIGURE 47—
PAGE 1 OF 1

Senator BOREN. I appreciate your comments very much and I agree with you, I think we can trace a lot of the development. We had something that was working and we fixed it all right back at that period of time, and it set in motion this whole path to centralization in which what had been basically a farmer-operated institution. The System became a lot closer to what we have and what we have now is a lot closer to Chase Manhattan Bank or something else than it is to the kind of direct farmer operation that we had when I used to go to those meetings as a kid.

Mr. STREBECK. We had the greatest success story of any cooperative in the world.

Senator BOREN. Absolutely.

Mr. STREBECK. I can remember, as field representative for the Federal Intermediate Credit Bank, if they had 20 people, at their annual stockholders meeting, they had a quorum and that was all they wanted. I can remember when we had just a few people at the annual stockholders meeting of our association. I can remember it also getting close to 1,000.

Senator BOREN. Right.

Mr. STREBECK. The association was viable, we were serving farmers' needs and we were working with them. Many of the farmers that have asked for my assistance to help restructure their debts are farmers that I have worked with since back in 1965. They have trust and confidence in me, something that they do not have in their local lending institutions.

Senator BOREN. It is tragic that this happened and it changes your attitude over a period of time. All you have to do is go look at the buildings that have been built around this country to know who has been serving whom.

Mr. STREBECK. I appreciate the opportunity to be here.

Senator BOREN. We build up a commercial banking structure here and asked the farmers to pay for it and the salary structures and everything else has gotten up to levels where it will not work any more, but we are trying to do something about it. It is a very frustrating process to try to undo a lot of damage that has been going the wrong way for the last 15 years or so, but we are trying very hard to turn it back in the right direction again, because we had something once that really worked well.

You are with the State extension service?

Mr. STREBECK. Yes, I am with the Louisiana Cooperative Extension Service.

Senator BOREN. Are you extension service people assisting a lot of farmers that are trying to figure out how to restructure and how to work with their creditors and so forth?

Mr. STREBECK. Yes, we are working with them. We have a computer program, a cash-flow plan, using the LSU estimated cost of production, and we develop a cash-flow plan for their farm business.

Senator BOREN. And you can work with them.

Mr. STREBECK. We give them three cash-flow plans; one with 100 percent expenses, one with 90 percent, and one with 110 percent.

Senator BOREN. Are the other States active with the extension service as well?

Mr. GLENN. Yes; in Oklahoma the OSU program. We require the IFMAPS or the VOTEC farm program to be done before we do mediation, so what he is describing is what we do as IFMAPS.

Senator BOREN. You are working on that as well. Are other States?

Mr. GLENN. Minnesota has been active and there are other programs as well, one from the Department of Agriculture——

Senator BOREN. Right.

Mr. GLENN [continuing]. That has provided a great deal of assistance. I think the important thing about what Mr. Strebeck has said is the absolute critical need for farmers to get the help that they need and do their homework, because the System is not going to do it for them, Farmers Home or Farm Credit, I think that day is past and I think the work that he is doing.

The other thing I just want to mention while I have the opportunity to Mr. Strebeck and the subcommittee, I have been in Louisiana, I have given workshops and lectures in Louisiana probably a half dozen times myself and my staff in the last couple of years, and people do not think of the farm crisis and the farmer is in trouble as much I guess in connection with Louisiana, but in Delhi, Louisiana and Alexandria, Louisiana, on two occasions, we have had between 275 and 300 family farmers come to workshops and lectures and listen about their legal rights and so on.

I think Mr. Strebeck has worked others, he is working with and is certainly pushing in the right direction in Louisiana, and I think that is another thing that we all should be doing in our communities.

Senator BOREN. Well, I want to thank all of you again. Senator Exon, we appreciate you joining us. Any last comment that you would like to make?

Senator EXON. Just a few brief comments. First, Mr. Chairman, I want to thank you very, very much for holding this hearing. I think it has been particularly important, because I share the concern that you, as the primary writer of this very important piece of legislation. You recognize the responsibility for oversight hearings, which is what this is all about, and I thank you for your help, your understanding. I just tell you that were it not for Gene Severens, as I said earlier, and then the followup of this hearing, after you and I discussed the problems, we would not have received the news that we received here this morning. I think there was little else that they could do but finally come in here and finally face the music.

Let me just thank you, then, for doing that and for all the help that you have been to us. Also, I want to thank you for being the man primarily responsible for Jim Billington being on the Farm Credit Board. He is an Oklahoman and I like Oklahomans except on that third Saturday in November, and you have been very compassionate and understanding. I am not going to get a commitment from you now. I hope you would be that compassionate and understanding the third Saturday in November this year. Do not say no, just take it under advisement. [Laughter.]

Seriously, Jim Billington has been a tower of strength. I have met with him on several occasions in this regard and with two good Oklahomans like you and Billington understanding the plight of

not only the farm sector in your area but the farm sector across the Nation. I am sorry that I could not be here and I am sorry that I was not here earlier, Mr. Chairman, although I appreciate your indulgence, since I am not a member of this subcommittee. As you know, I am very actively involved, as much as anybody else who is not a member of this committee and probably more so than some Senators that are.

We look to your direction and leadership. Thank you for your help. Just let me say this: I could not be here this morning because I was in conference with the House trying to work out the Defense Authorization bill on all the arms control matters, and you know how complicated those are, as the chairman of the Intelligence Committee.

I came back hoping I could hear more. I do want to read the input that will be printed in the record from this panel, because this is the panel that I know understands the problems that we face out there, and I want to simply say that I hope maybe we can get the word across.

When we hear complaints about write-downs, that is bad, if we hear things about giving them a preferred interest rate, that is bad, not having complete understanding, that is bad, some people think. All that I have ever asked for is for us in government to make sure that government and its agencies give the same consideration to a Nebraska farmer or rancher as they would to Third World countries that are obviously bankrupt, broke and are never going to be able to pay their bill, but we do not close them out because I guess we cannot afford to.

The fact of the matter is we cannot afford, in my opinion, to——

Senator BOREN. We do not even close out banks if they are big enough.

Senator EXON. That is right.

Senator BOREN. Maybe the little ones we close up, but not the big ones.

Senator EXON. If we could just get the farmers to be a whole lot bigger and in a whole lot more trouble, then we could not afford to close them out.

I also picked up what I think is a very important must here, lots of problems coming down the line I think in this whole System, Mr. Chairman. The drought, even if we got rains today, the drought is going to cause lots of problems in the System and I think it is critically important that we send a message out that you have here, to get those farmers and ranchers who serve on these boards active in the management of the System and not passively.

I happen to know that the question of requesting certification was not favored by the management of the System headquartered in St. Paul, Minnesota, but in that case the farmer representatives says that is what we want and they directed it and followed through.

In the Omaha situation, for whatever the reason, the farmers were not actively involved and they just went along with the bank management. If farmers and ranchers are going to be board of directors, they had better understand that they have a responsibility and they are not just board of directors in name only. They have got to get involved and they are responsible, just as much as the

management of that bank is, if the farmers and ranchers in their area are let down.

Thank you very much for coming. It is very important testimony. Thank you once again, Mr. Chairman, for holding these hearings.

Senator BOREN. Thank you, Senator Exon. I know that at least one board member in the room that takes that kind of active interest. He was nodding his head and he has been one that listens all the time and is very involved and sat here to listen to all of this today, too, and he is an example of the kind of board members we need all through the System.

I want to thank you for your comments. I am sure your associate here from Nebraska knows the role that you have played. I never forget when I first became a Governor and started attending governors conferences and meetings, you were chairing the agricultural sector at many of those meetings of the agricultural committee, and you became one of those people that really began to educate me about agricultural economics. And while you are not a member of this committee, I think you are very accurate in saying there are not two or three members of this committee that come as close to being as active as you are on agriculture in general in the Senate, and I appreciate it very, very much and appreciate what you do and the care and the concern that you demonstrate and feel.

I think we would like to say that to the panel. There are people here on this committee and there are people like Senator Exon in the Senate, in general, that have a real deep concern about the experiences that people are going through. That is why we labored so hard and so long over this legislation. People told us we would never get it passed and we could never get an agreement and we could never get a bill that could be passed and signed. We finally did, and after all our work we are determined not to sit back and see the purposes of it be frustrated now because of the failure to implement it in the right way.

We are going to keep pushing. We understand it is going to take constant effort and it is going to be a very frustrating process, but this has been very helpful information here today and we appreciate your taking the time to come. I think you have really presented the concerns of those that you are seeing every day, those whose lives are being touched by this in a very effective manner.

Senator EXON. Mr. Chairman, you have been wonderful. Just keep on talking. You could totally make my day if you would resolve football matters.

Senator BOREN. The only way I know to take care of the Senator from Nebraska and his football problem is that I have every year supplied him with a very large supply of Kleenex on the appropriate day. I have had a page deliver it to him very thoughtfully on the Senate floor on at least two occasions. That is the only way I know to take care of that problem. [Laughter.]

Senator EXON. You cannot win them all.

Senator BOREN. Thank you very much. We will stand in recess.

[Whereupon, at 2:27 p.m., the subcommittee recessed, to reconvene at 9:50 a.m., Friday, September 30, 1988, in room SR-332, Russell Senate Office Building.]

[Material submitted for inclusion in the record follows:]

Statement of Senator John Melcher to Accompany Gill Testimony: June 16, 1988

I would like to introduce into the record the statement of Mr. Tim H. Gill, president of Montana Livestock Ag Credit, Inc. Montana Livestock is an OFI that paid off its loans to the Spokane FICB two and one-half years ago. It has been trying to recover its capital in the FICB ever since. Mr. Gill makes two important points that warrant emphasis.

First, the plan of merger submitted by any district in which there are OFIs that have repaid their loans to the FICB should include a definite, reasonably short schedule for retiring the OFI's eligible borrower stock. If necessary, the FCA should require such a provision as a condition of approving the plan of merger.

Second, there is no reason to deny Farm Credit System shareholders the right to withdraw their investment from the Farm Credit Bank created by the § 410 merger, provided the shareholders have satisfied their obligations to the system institutions. There never was any intent to make any Farm Credit System shareholder an involuntary, captive investor.

Statement of Tim H. Gill,
Montana Livestock Ag Credit, Inc.

My name is Tim Gill. I am president of Montana Livestock Ag Credit, Inc, which until a few years ago was a production credit association ("PCA") in the Twelfth Farm Credit District. In October, 1985, we repaid our loans from the Spokane Federal Intermediate Credit Bank ("FICB"), and reorganized the company under Montana law. Because the Farm Credit Act prohibited a non-PCA from holding Class B stock in an FICB, we qualified ourselves as an "other financial institution" ("OFI"), and the Spokane FICB issued participation certificates to us in place of our Class B stock. We also retained an equity interest in the Spokane bank's allocated reserves.

We have not borrowed any money from the Spokane FICB or had any other business dealings with them since October, 1985. We did not insist on immediate retirement of our stock in 1985, but since then we have tried everything short of litigation to have the bank retire our equity. We even offered to negotiate a schedule for retirement, which could take into account any legitimate financial concerns of the FICB. Nonetheless, for two and one-half years, the Spokane FICB has refused to retire our equity or to negotiate a schedule for retirement.

The Agricultural Credit Act of 1987 makes the Spokane FICB refusal to retire our equity untenable. Montana Livestock's participation certificates and allocated equity are eligible borrower stock, protected under § 4.9A of the Act (101 Stat. 1572-73), and therefore, are not "permanent capital" under § 4.3A of the Act (101 Stat. 1609-10).* The protected stock provisions and the permanent capital provisions of the Act both rest on the premise that eligible borrower stock will be retired when a stockholder's loans from Farm Credit System institutions are repaid. The distinction in the Act between protected stock and permanent capital would be meaningless, if protected stock never need be retired. Further, unless a stockholder is entitled to have his

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* The Farm Credit Administration has acknowledged that "all stock, participation certificates, and allocated equities owned by borrowers and other financial institutions (OFIs) on the date of enactment of the 1987 Act, or issued within the earlier of 9 months after such date of enactment or the implementation of a new capitalization plan by the institution involved," are "eligible borrower stock," protected under § 4.3A. 53 Fed. Reg. 6968, 6969 (May 12, 1988).

stock retired, the federal guarantee of par value is worthless. The federal guarantee is of no practical significance to the shareholders of a solvent institution, if its management can simply decide not to retire the stock.

The recent amendments to the Farm Credit Act also make it imperative that this matter be resolved promptly. The mandatory merger of each district FICB and Federal Land Bank required by § 410 of the Act (101 Stat. 1637) will produce a new Farm Credit Bank that is fundamentally different from the Spokane FICB. No Farm Credit System borrower should be forced to become an investor in the new enterprise, if he has satisfied his obligations to the system institutions. Like the stockholders of state corporations, the stockholders of a federally chartered corporation should be permitted to withdraw their investment from the new enterprise.* There is no reason to believe Congress intended to deny Farm Credit System stockholders this basic protection against becoming involuntary, captive investors.

Further, the Act requires system banks to move toward capitalization with permanent, at risk capital. Consistent with this objective, there is evidence Congress intended that the plans of merger adopted for each district under § 410 of the Act provide for retiring the protected stock of persons who repaid their loans to the system in full.** Moreover, even if the Act does not explicitly require that the plans of merger include such provisions, the FCA plainly has authority to require them, subject to such conditions as it believes appropriate, and the agency should exercise that authority. There clearly is nothing in the Act that would preclude the FCA from insisting that each district make adequate provision for retiring the stock of borrowers who repay their loans in full prior to the § 410 mandatory

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* Under so-called "right of appraisal" statutes or "dissenters' rights" statutes, virtually every state in the nation allows a shareholder to withdraw his investment from an institution that undergoes a fundamental reorganization without the stockholder's concurrence. See, e.g., Wash. Rev. Code Ann. § 23A.24.030. Absent any contrary legislative intent, a similar right should be recognized for Farm Credit System stockholders under federal common law, if the stockholder has repaid any outstanding obligations to the system institution.

** See Letter from Senators Patrick Leahy, Richard G. Lugar, and John Melcher to Kenneth Krueger (May 19, 1988); see also Statement of Senator David K. Karnes in Hearings Before the Subcommittee on Agriculture, Nutrition, and Forestry, page 5. For convenience, copies of both documents accompany my testimony.

merger. At a minimum, the plan of merger should include a definite schedule for retiring protected eligible borrower stock held by an OFI that repaid all outstanding obligations to Farm Credit institutions more than two years ago.

We have urged the FCA to modify the plan of merger submitted by the Twelfth Farm Credit District to include a schedule for retiring the Montana Livestock equity. Thus far, however, the FCA has taken no action.

The Honorable David L. Boren
Chairman
Subcommittee on Agricultural Credit
Committee on Agriculture, Nutrition
& Forestry
328A Russell Senate Office Building
Washington, D.C. 20510

June 16, 1988

Dear Senator Boren:

The undersigned farm and commodity organizations would like to take this opportunity to comment on the implementation of the Agricultural Credit Act of 1987, PL 100-233.

From our perspective, the congressional content of this legislation was to recapitalize and modify the structure of the ailing farm credit system, while providing an opportunity for system borrowers to restructure distressed loans as well as create a secondary market for agricultural real estate loans. Today, approximately six months since being signed into law, the process of implementing this act is taking shape. At this junction, we believe it is fair to say that the implementation process is both positive and negative.

On the positive side, a significant number of deserving farmer-borrowers have been or are in the process of having their loans restructured. While statistically the number of loans which have been restructured is impressive, the true measure of success of this program can only be gauged on a case-by-case basis. For the most part, this important debt management tool for farmers has worked well, unfortunately, cases continue to persist which would indicate that this initiative has not been carried out to the fullest intent of either Congress or the law. The agricultural Secondary Mortgage Market or "Farmer Mac" may well be the most aggressively pursued initiative within the Act. Clearly, if the Farm Credit System, it's regulator and other ancillary entities were to work as intensely and aggressively to put the balance of this legislation into place as those parties interested in the Secondary Market, American Agriculture and the Farm Credit System itself would reap the benefits. Finally, on the positive side, the Farm Credit System is, if nothing else, perceived to be achieving the goal of this legislation -- of regaining its status as a competitive, financially-solid and farmer-borrower oriented agricultural lender.

Mr. Chairman, while a number of very positive developments are occurring, likewise, a few trouble spots still exist. From across the country, reports continue to persist that "system-driven heel dragging" is creating difficulties and inconveniences as farmer/borrowers attempt to restructure loans, fully understand the implications of new capitalization requirements and/or mergers and structural reorganization efforts. While difficult, if not impossible to overcome, the effect of personalities, politics and financial interests continue to plague the implementation of Act. In addition, the Farm Credit System neither should attempt or be expected to regain any substantive portion of lost loan volume or market share overnight. Attempting to do so may well lead to a return to familiar financial difficulties the System has faced over the past three years. The Agricultural Credit Act of 1987 is a vital public law. At this point, the difficult task of implementing this statute, while far from perfect, has been promising. Through the continued pressure and oversight from Congress and of farmer-borrowers themselves, this Act will recapitalize and restructure the Farm Credit System as intended, and return it to the position of a leading and competitive lender to American agriculture.

Thank you for your consideration of our comments on this important issue.

Sincerely,

American Farm Bureau Federation
National Association of Wheat Growers
National Cattlemen's Association
National Corn Growers Association
National Cotton Council
National Pork Producers Council

cc: The Honorable Rudy Boschwitz

Farm Credit Banks
of St. Louis

Special Credit Department
1013 N. First St.
DeKalb, Illinois 60115
Telephone (815) 756 8409

Wednesday April 20, 1988

Kingston, IL 60145

FLB Loan No: 7420385500
OFFER OF SETTLEMENT

Dear

Federal Land Bank of St. Louis will make one last settlement offer prior to the completion of the foreclosure of Federal Land Bank vs. Henry C. Lanan, etal. (Case No. 85-CH-4). All items outlined in John Olson's letter dated March 2, 1988 will be addressed:

1. Federal Land Bank will accept a Deed-In-Lieu and/or transfer to a third party buyer acceptable to FLB, of the 352 acres of FLB security plus a $60,000.00 cash payment.

2. Federal Land Bank will accept a Deed-In-Lieu and/or transfer to a third party buyer acceptable to FLB, of the 347 acres of security not including the house and 5 acres located on the home farm. FLB will restructure a note in the amount of $105,000 secured by a first mortgage on the 5 acres and a first lien on all machinery and equipment with an approximate value of $75,000.00. Terms of the note will be 10.25% interest rate, fixed for four (4) years, 28 year amortization, and an eight (8) year balloon. Interest on the note will start accruing September 1, 1988 and the note will require March 1 annual payments with the 3/1/89 payment being interest only.

3. A new settlement offer of a Deed-In-Lieu while retaining 80 acres with FLB financing will not be made since all property has been rented out for the 1988 crop year. You were offered the opportunity to submit a written offer to rent the 152 acres back for the 1988 crop year. Our previous Memorandum of Settlement outlines the terms and conditions of settlement of this alternative and FLB does not wish to alter those terms at this time.

4. A settlement offer of Deed-In-Lieu of 200 acres (Sec. 33, TWP 42N/RGE 4E) while retaining 152 acres (Sec. 3, TWP 41N/RGE 4E) with financing at the National Bank and Trust of Sycamore will not be made since a counter offer was made on 8/27/87 to National Bank and Trusts' offer dated 7/31/87. The terms and conditions were not acceptable to them, therefore, this is considered an alternative not worthy of further consideration.

It must be understood by all parties that any settlement offer reached will require you to forgive all rights under the "Agricultural Credit Act of 1987". If a written response of acceptance to this offer is not received by Friday April 29, 1988 this offer will be conidered null and void. Federal Land Bank will then immediately obtain a judgement of foreclosure. Further if any of the above offers of settlement are accepted, the matter must be completed and closed by May 15, 1988.

Sincerely,

Larry C. Thomas
Manager

LCT/clt

cc: Schluetter, Ecklund, Olson, Barrett & Moore
4023 Charles Street
Rockford, IL 61108
Mr. John Olson
Attorney-At-Law

RESOLUTION OF THE BOARD OF DIRECTORS OF
FARM CREDIT CORPORATION OF AMERICA

LOAN RESTRUCTURING AND BORROWER RIGHTS

WHEREAS, the Agricultural Credit Act of 1987 (the Act) requires each Farm Credit District Board to adopt a distressed loan restructuring policy; and

WHEREAS, this Board believes it is in the best business interest of the Farm Credit System and its member-borrowers that the loan restructuring and borrower rights provisions of the Act be applied uniformly throughout the System; and

WHEREAS, this Board believes it is in the best business interest of the Farm Credit System and its member-borrowers that the loan restructuring and right-of-first-refusal provisions of the Act be applied broadly, in the spirit of the Act, even though the Act by its terms requires only prospective application of such provisions; and

WHEREAS, a Model Distressed Loan Restructuring Policy (the Policy) was developed and unanimously recommended by a work group of system attorneys comprised of at least one representative from each district; and

WHEREAS, the Farm Credit System Presidents Planning Committee reviewed and unanimously approved the Policy on January 25, 1988; and

WHEREAS, this Board has reviewed and carefully considered the proposed Policy and related implementation issues.

NOW, THEREFORE, BE IT RESOLVED, that this Board hereby approves, and recommends that the board of directors of each Farm Credit District approve and adopt as the loan restructuring policy for qualified lenders in their district, the Model Distressed Loan Restructuring Policy attached hereto and made a part hereof by this reference;

FURTHER RESOLVED, that this Board urges and recommends that each Farm Credit District, in connection with Federal land bank and production credit association loans that were the subject of a foreclosure proceeding on the date of enactment of the Agricultural Credit Act of 1987, undertake a review of the notice and forbearance procedures followed prior to the initiation of the foreclosure proceeding to confirm that the Congressional intent embodied in the Act was substantially complied with. The Board further urges and recommends that, when warranted following such review, the appropriate System institution voluntarily afford the borrower an opportunity to submit a restructuring proposal in accordance with the provisions of Title I of the Act;

FURTHER RESOLVED, that this Board urges and recommends that each Farm Credit District, in connection with acquired property in the inventory of the Federal land bank or a production credit association on the date of enactment of the Act, voluntarily undertake, to the extent practicable and without prejudicing the rights of the institution or any third party, to contact the previous owners of such property and afford them an opportunity to purchase their former property at its fair market value. This Board further urges and recommends that, where such individuals are unable to purchase their former property at its fair market value and the institution is unable to sell such property to a third party, the previous owners be afforded an opportunity to lease their former property at its fair rental value, unless the institution determines that the previous owner (1) does not have the resources available to conduct a successful farming or ranching operation, or (2) cannot meet all of the payments, terms, and conditions of the lease.

I certify that this is a true and accurate copy of a resolution passed by the FCCA board on January 26, 1988.

FARM CREDIT CORPORATION OF AMERICA CORPORATE SEAL

Michael [illegible]
Corporate Secretary

MODEL DISTRESSED LOAN RESTRUCTURING POLICY

I. INTRODUCTION

The following sets forth the Restructuring Policy of the _____ Farm Credit District. This policy governs the restructuring of distressed loans made by qualified lenders ("lenders"), as defined below, and their successors. The policy does not apply to loans made by the _____ Bank for Cooperatives.

All lenders in the _____ Farm Credit District have an obligation to borrowers, stockholders, and investors in System debt obligations to collect all debts owed to the lender and all borrowers are expected to comply with contractual loan terms and conditions. In those instances where a district lender determines that the borrower's loan is a distressed loan, the lender shall consider restructuring in accordance with this policy.

II. DEFINITIONS

Cost of Restructuring - In determining whether the potential cost to the lender of restructuring a distressed loan is less than or equal to the potential cost of foreclosure, the lender shall consider the following:

(A) the present value of interest income and principal forgone by the lender in carrying out the restructuring plan;

(B) reasonable and necessary administrative expenses involved in working with the borrower to finalize and implement the restructuring plan, including attorneys' fees, costs, and other expenses advanced by the lender pursuant to the loan documents;

(C) whether the borrower has presented a preliminary restructuring plan and cash-flow analysis taking into account income from all sources to be applied to the debt and all assets to be pledged, showing a reasonable probability that orderly debt retirement will occur as a result of the proposed restructuring;

(D) whether the borrower has furnished or is willing to furnish complete and current financial statements in a form acceptable to the lender; and

(E) any other factors considered relevant by the lender that bear upon the individual restructuring decision, including but not limited to the following:

(1) whether the borrower is applying all income over and above necessary and reasonable living and operating expenses to the payment of primary obligations;

(2) whether the borrower has the financial capacity and the management skills to protect the collateral from diversion, dissipation, or deterioration;

(3) whether the borrower is capable of working out existing financial difficulties, reestablishing a viable operation, and repaying the loan on a rescheduled basis; and

(4) in the case of a distressed loan that is not delinquent, whether restructuring consistent with sound lending practices may be taken to reasonably ensure that the loan will not become a loan that it is necessary to place in non-accrual status.

Loan - The term "loan" means a loan made to a farmer, rancher, or producer or harvester of aquatic products, for an agricultural or aquatic purpose and other credit needs of the borrower, including financing for basic processing and marketing directly related to the borrower's operations and those of other eligible farmers, ranchers, producers or harvesters of aquatic products.

Distressed Loan - The term "distressed loan" means:

(A) A loan that the borrower does not have the financial capacity to pay according to its terms, and

(B) that exhibits one or more of the following characteristics:

(1) The borrower is demonstrating adverse financial and repayment trends.

(2) The loan is delinquent or past due under the terms of the loan contract.

(3) One or both of the factors listed in subparagraphs (1) and (2), together with inadequate collateralization, present a high probability of loss to the lender.

Application for Restructuring - The term "application for restructuring" means a written request —

(A) from a borrower for the restructuring of a distressed loan in accordance with a preliminary restructuring plan proposed by the borrower as part of the application;

(B) submitted on the appropriate forms prescribed by the lender; and

(C) accompanied by sufficient financial information and repayment projections as required by the lender to support a sound credit decision.

Cost of Foreclosure - The term "cost of foreclosure" includes —

(A) the difference between the outstanding balance due on a loan made by a lender and the liquidation value of the loan, taking into consideration the borrower's repayment capacity and the liquidation value of the collateral used to secure the loan;

(B) the estimated cost of maintaining a loan as a nonperforming asset;

(C) the estimated cost of administrative and legal actions necessary to foreclose a loan and dispose of property acquired as the result of the foreclosure, including attorneys' fees and court costs;

(D) the estimated cost of changes in the value of collateral used to secure a loan during the period beginning on the date of the initiation of an action to foreclose or liquidate the loan and ending on the date of the disposition of the collateral; and

(E) all other costs incurred as the result of the foreclosure or liquidation of a loan.

Foreclosure Proceeding - The term "foreclosure proceeding" means —

(A) a foreclosure or similar legal proceeding to enforce a lien on property, whether real or personal, that secures a nonaccrual or distressed loan; or

(B) the seizing of and realizing on nonreal property collateral other than stock, participation certificates allocated surplus, or investments in equity reserve in a Farm Credit System institution.

Restructuring - The term "restructuring" includes rescheduling reamortization, renewal, deferral of principal or interest, monetary concessions, and the taking of any other action to modify the terms of, or forbear on, a distressed loan

in any way that will make it probable that the operations of the borrower will become financially viable.

Qualified Lender - The term "qualified lender" means —

(A) An institution of the Farm Credit System that makes loans (as the term loan(s) is defined above), excluding the _____ Bank for Cooperatives; and

(B) Other Financing Institutions ("OFI"), as defined in Section 2.3(a)(2) of the Farm Credit Act of 1971, as amended, but only with respect to loans discounted or pledged by such OFI to the Federal Intermediate Credit Bank of _____ ("FICB"), or the FICB's successor, should the FICB merge with another bank.

III. RESTRUCTURING CRITERIA

When a lender receives an application for restructuring from a borrower and the lender determines that the loan is a distressed loan, the lender shall determine whether or not to restructure the loan, taking into consideration the potential cost of restructuring the loan and the potential cost of foreclosure as those terms are defined in this policy. If a lender determines, in its sole discretion, that the potential cost to the lender of restructuring the loan in accordance with a proposed restructuring plan is less than or equal to the potential cost of foreclosure, the lender shall restructure the loan in accordance with the plan. The term "cost" as used herein includes all factors relevant to making a sound credit decision.

This policy shall not prevent a lender from proposing a restructuring plan for a borrower, but the lender is under no obligation to do so. A lender is not required to consider a distressed loan for restructuring unless the borrower submits an application for restructuring pursuant to this policy.

If two or more restructuring alternatives are available to a lender under this policy with respect to a distressed loan, one or more of which alternatives may be proposed by the lender, the lender shall restructure the loan in conformity with the alternative that results in the least cost to the lender.

IV. APPLICATION PROCEDURES

Any borrower who has been notified that his loan may be suitable for restructuring, may submit an application. To apply, the borrower shall submit an application for restructuring as defined herein to the appropriate lender. To be considered, an application must be received by the lender in accordance with the time period set by the lender but the time period allowed for a borrower to submit an application should not be less than 45 days from the date of the lender's

first notice to the borrower that the loan may be suitable for restructuring, plus an additional three days if the notice is mailed. If an application is not received by the lender within the set time period, the lender may begin foreclosure proceedings and will be under no obligation to consider an application after foreclosure proceedings have commenced.

V. PREVENTIVE ACTIONS

Nothing contained in this policy shall be construed to prevent any lender from enforcing any contractual provisions that allow the lender to foreclose a loan, or from taking such other lawful action as the lender deems appropriate, if the lender has reasonable grounds to believe that the loan collateral will be destroyed, dissipated, consumed, spent, concealed, or permanently removed from the State in which the collateral is located.

VI. MEETINGS

On determination by a lender that a loan is or has become a distressed loan, the lender shall provide a reasonable opportunity for the borrower to personally meet with a representative of the lender —

(A) to review the status of the loan, the financial condition of the borrower, and the suitability of the loan for restructuring; and

(B) with respect to a loan that is in nonaccrual status, to develop a plan for restructuring the loan if the loan is suitable for restructuring.

VII. NOTICE TO BORROWERS

On a determination by a lender that a loan is or has become a distressed loan, but no later than 45 days before an institution begins foreclosure proceedings, the lender shall provide written notice to the borrower that the loan may be suitable for restructuring and include with such notice:

(A) a copy of this restructuring policy; and

(B) the appropriate forms necessary to enable the borrower to submit an application for restructuring the loan.

VIII. NOTICE OF DECISION

The borrower's application for restructuring shall be processed and acted upon expeditiously in conformance with normal loan processing procedures. Upon taking action on an application for restructuring, the lender shall provide prompt written notice of its decision to the borrower, including the terms and conditions of the restructuring if approved, or the reasons for

the denial if not approved. The notice shall also advise the borrower of his right to receive a review as provided for herein.

IX. REVIEW

A borrower who has received notice of a decision to deny an application for restructuring a distressed loan may request a review of such decision by the appropriate credit review committee. Any request for review must be made in writing and received within 7 days (plus an additional 3 days if the lender's notice of denial is mailed) of the date of the lender's written notice of its denial of restructuring. The borrower may appear in person before the credit review committee, and may be accompanied by counsel or by any other representative of such person's choice, to seek a reversal of the decision on the application under review. The borrower may submit any relevant documents or other information to support the information in the restructuring application. Review by the credit review committee will be limited to the application, as supplemented by relevant documents or evidence supporting the information contained in the application. Documents or evidence containing new information that was not mentioned in the application may not be submitted by the applicant and will not be considered by the credit review committee in reviewing the application for restructuring.

If a lender required additional collateral as a condition to restructuring the loan and the application for restructuring was denied because the borrower was not able or willing to provide additional collateral, a request for review filed with the credit review committee under this policy may include a request for an independent appraisal by an accredited appraiser. If such a request is made, the credit review committee shall present the borrower with a list of three appraisers approved by the lender from which the borrower shall select an appraiser to conduct the appraisal, the cost of which shall be borne by the borrower, and shall consider the result of such appraisal in any final determination with respect to the application for restructuring. A copy of any appraisal made pursuant hereto shall be provided to the borrower and the credit review committee prior to the credit review committee meeting.

The credit review committee shall reach a decision on the application for restructuring in its sole discretion and such decision shall be the final decision of the lender with respect to restructuring on the loan. The credit review committee shall promptly notify the borrower in writing of the committee's decision and the reasons therefore.

doc6
1/18/88

X. EFFECT OF RESTRUCTURING ON BORROWER STOCK

If a lender forgives and writes off any of the principal outstanding on the loan made to any borrower in connection with restructuring of a loan pursuant to this policy, the System institution of which the borrower is a member and stockholder shall cancel the same dollar amount of borrower stock held by the borrower in respect to the loan at the time of the restructuring, up to the total amount of such stock. Notwithstanding the fact that stock shall be cancelled pursuant to this policy, the borrower shall be entitled to retain at least one share of stock to maintain the borrower's membership and voting interest in the applicable System institution, if the borrower was a stockholder at the time of the restructuring.

MODEL DISTRICT BOARD RESOLUTION
LOAN RESTRUCTURING AND BORROWER RIGHTS

WHEREAS, the Agricultural Credit Act of 1987 (the Act) requires each Farm Credit District Board to adopt a distressed loan restructuring policy; and

WHEREAS, this Board believes it is in the best business interest of the Farm Credit System and its member-borrowers that the loan restructuring and borrower rights provisions of the Act be applied uniformly throughout the System; and

WHEREAS, this Board believes it is in the best business interest of the Farm Credit System and its member-borrowers that the loan restructuring and right-of-first-refusal provisions of the Act be applied broadly, in the spirit of the Act, even though the Act by its terms requires only prospective application of such provisions; and

WHEREAS, a Model Distressed Loan Restructuring Policy (the Policy) was developed and unanimously recommended by a work group of system attorneys comprised of at least one representative from each district; and

WHEREAS, the Farm Credit System Presidents Planning Committee reviewed and unanimously approved the Policy on January 25, 1988; and

WHEREAS, the Farm Credit Corporation Board of Directors unanimously approved the Policy on January 26, 1988, and recommended it to each District board for adoption; and

WHEREAS, this Board has reviewed and carefully considered the proposed Policy and related implementation issues.

NOW, THEREFORE, BE IT RESOLVED, that this _____ Board hereby approves and adopts, as the loan restructuring policy for qualified lenders in this district, the Model Distressed Loan Restructuring Policy attached hereto and made a part hereof by this reference;

FURTHER RESOLVED, that this Board hereby directs management, in connection with Federal land bank and production credit association loans that were the subject of a foreclosure proceeding on the date of enactment of the Agricultural Credit Act of 1987, to undertake a review of the notice and forbearance procedures followed prior to the initiation of the foreclosure proceeding to confirm that the Congressional intent embodied in the Act was substantially complied with. The Board further directs that, when warranted following such review, the appropriate System institution voluntarily afford the borrower an opportunity to submit a restructuring proposal in accordance with the provisions of Title I of the Act;

FURTHER RESOLVED, that this Board hereby directs management, in connection with acquired property in the inventory of the Federal land bank or a production credit association on the date of enactment of the Act, to voluntarily undertake, to the extent practicable and without prejudicing the rights of the institution or any third party, to contact the previous owners of such property and afford them an opportunity to purchase their former property at its fair market value. This Board further directs that, where such individuals are unable to purchase their former property at its fair market value and the institution is unable to sell such property to a third party, the previous owners be afforded an opportunity to lease their former property at its fair rental value, unless the institution determines that the previous owner (1) does not have the resources available to conduct a successful farming or ranching operation, or (2) cannot meet all of the payments, terms, and conditions of the lease.

J. JAMES EXON
NEBRASKA

[illegible]
WASHINGTON, DC 20510

207 FEDERAL BUILDING
LINCOLN, NE 68508

8305 FEDERAL BUILDING
OMAHA, NE 68102

275 FEDERAL BUILDING
NORTH PLATTE, NE 69101

United States Senate

WASHINGTON, DC 20510

COMMITTEES
ARMED SERVICES
COMMERCE, SCIENCE AND TRANSPORTATION
BUDGET

May 20, 1988

The Honorable David L. Boren
Chairman
Subcommittee on Agricultural Credit
Committee on Agriculture, Nutrition, and Forestry
United States Senate
Washington, D.C. 20510

Dear David:

During the past week there has been considerable debate in Nebraska regarding the Omaha Federal Land Bank's (FLB) decision not to seek certification for assistance under the Agricultural Credit Act of 1987. I am writing to seek your counsel as chairman of the Subcommittee on Agricultural Credit and request a legal interpretation from you since your Subcommittee essentially wrote this legislation and shepherded it through Congress.

The enclosed letter from the Center for Rural Affairs in Walthill, Nebraska, outlines the fundamental areas of concern. In brief, the Center states that the Omaha FLB is required to seek certification for assistance because the value of its stock is below the 75 percent threshold established in the 1987 Act. Bank officials, on the other hand, contend that it would be inappropriate to apply to the Assistance Board for certification because the value of its stock will exceed the 75 percent level after the July 6th merger between the Omaha FLB and the Omaha Federal Intermediate Credit Bank. The fact that the Omaha FLB's stock has been been below the 75 percent level since enactment of the Agriculture Credit Act of 1987 further heightens my concern over the compliance questions at issue in this debate.

Certification for assistance, as you know, is more than a technicality. Establishment of the demonstration program for the sale of system land as provided under Section 613 of the 1987 Act is contingent upon a system institution's certification for assistance.

I would also appreciate knowing which specific entity, under the law as you read it, is responsible for seeking certification. It seems clear from the Omaha Bank's correspondence that they have no intention of doing so. News reports like the one enclosed also suggest that the Farm Credit Assistance Board is not prepared to require certification. I would certainly hate to see this debate degenerate into a "finger pointing" exercise if Nebraska farmers and ranchers are the ones who get hurt in the process.

Finally, I have two other areas of concern. First, what are the possible effects that a delay in certification and the corresponding oversight provided by Congress in the 1987 Act could have on the Omaha Federal Intermediate Credit Bank (FICB). Simply put, will the Omaha FICB be forced to "ante up" more to stabilize the merged institution if the certification and oversight processes are avoided?

Second, I am concerned about the legal impact which avoidance of certification could have on the Omaha Federal Land Bank. It seems possible that, should the courts find the Omaha Federal Land Bank in violation of the the 1987 Act, any adverse action taken by the Bank during the period of violation would be jeopardized. That certainly seems to be a high-risk legal posture for the Omaha FLB to assume.

I understand that on Monday, May 23rd, your Subcommittee on Agricultural Credit will hold oversight hearings on the 1987 Act's effect on the Jackson Bank. If appropriate, I would appreciate your exploring these topics with Farm Credit Administration officials at that time as well. I also look forward to receiving your legal interpretation on these questions since there seems to be a dispute over implementation of this law which is under your oversight jurisdiction.

Thank you in advance for your assistance.

With best wishes.

Sincerely,

J. James Exon
United States Senator

Enclosures

cc: Senator Patrick J. Leahy
Senator Tom Harkin
Senator Thomas A. Daschle
Senator David K. Karnes

May 10, 1988

Senator J. J. Exon
U. S. Senate
SH-330
Washington, DC 20210

Dear Senator Exon:

Thank you for asking me to attend the meeting with Eric Thor, president of the Farm Credit System Assistance Board, in Omaha on May 6, 1988. I want to use this letter to report to you on two disturbing revelations made by Mr. Thor at that meeting. Since both these involve serious consequences not only for all taxpayers, but particularly for farmer-stockholders and all re-entry and beginning farmers in the four-state Omaha district, I am sending copies of this letter to the congressional delegations of Iowa, South Dakota, and Wyoming as well as Nebraska.

First, Mr. Thor formally acknowledged that the Omaha Federal Land Bank has not applied for Assistance Board "certification" even though the value of its stock was under 75% of par value. This 75% level is the threshhold, established by the new Ag Credit Act of 1987 [SEC. 6.4(b)], which triggers the requirement that an institution below the 75% threshhold must apply to the Assistance Board for certification. This formal statement is important because it contradicts a senior Omaha bank official, John Daubert, who implied in a March 24th Lincoln Journal article (attachment 1), that the Omaha bank was in the process of applying for certification. Mr. Daubert said the Omaha bank had submitted financial plans to the Assistance Board and that "the plans are the first step in getting certification." Mr. Thor, himself, in that same article, refused to say whether the Omaha bank management had applied.

The "good news" in Mr. Thor's statement is that all the mystery and misinformation concerning the Omaha management's application for certification has been finally set straight. The "bad news" is that the Omaha officials' failure to apply for certification under the new act puts the Omaha FLB in violation of the law. The Omaha officials' violation undermines Congress' carefully deliberated bailout oversight scheme and has serious consequences not only for all federal taxpayers but for Omaha district borrowers and re-entry and beginning family farmers--all of whom have much to gain from certification (discussed below).

As you can see from the enclosed copy of my letter (attachment 2) to John Martin, Senior Vice President of the Omaha Farm Credit Services, Mr. Martin confirmed that Mr. Thor's statements are accurate (the Omaha FLB is under the 75% threshhold and it has not applied for certification). However, when confronted with my conclusion that the Omaha officials were acting illegally by not applying under SEC 6.4, he volunteered that the Omaha officials had "provided documents" to the Assistance Board--an attempt, apparently, to create the impression that the Omaha bank is in compliance. But Mr. Thor, at the May 6th meeting, said categorically that the Omaha management had not applied, so whatever these documents are, they do not satisfy the SEC. 6.4 requirement that an institution under the 75%

threshhold must apply for certification with the Assistance Board.

The second revelation by Mr. Thor was that the Assistance Board has no responsibility to deal with the Omaha bank management's unlawful refusal to ask for certification. He admitted, under questioning, that he had "monitoring" responsibility over the Omaha FLB under SEC. 6.4(a) but no "regulatory" responsibility for forcing the Omaha district to apply. Instead, he suggested that the Farm Credit Administration was the proper regulator which should confront the Omaha FLB management with its SEC. 6.4 noncompliance. While the Assistance Board and the FCA take 6 months to figure out which one of them is the regulator, the Omaha officials have free rein to openly violate the law and deprive Omaha district farmers and ranchers and all federal taxpayers of the special opportunities and protections intended by the certification process.

The "certification issue" is quite straight forward. As I say in the enclosed letter to Mr. Martin, confirming my May 10th phone conversation with him, it is a cut-and-dried procedure with little, if any, room for interpretation. If an institution is under the 75% threshhold--and everyone admits the Omaha FLB is, they must apply for certification. The enclosed photocopy from the winter issue of our Small Farm Advocate, describes the 3-step process (attachment 3).

An important point in the law's oversight scheme (a point over which, I believe, the Omaha officials have created deliberate confusion), is the fact that Assistance Board "certification" is not the same thing as receiving "financial assistance." Financial assistance comes later, and only if necessary, when the Assistance Board authorizes the certified institution to issue preferred stock under SEC. 6.27. The Conference Report (HR 100-490, p. 185) states this clearly: "The conferees read this provision [SEC. 6.4(b)] to allow the certified institution to apply for assistance and to be certified by the Assistance Board under such terms and conditions as it may specify, but not to require the institution to then immediately, or for that matter to ever, issue preferred stock" (my emphasis). At the U. S. Treasury Department's urging, Congress intended that the "certification stage" be used by the Assistance Board to explore "noncash-type assistance" to avoid "necessitating the issuance of additional Government-guaranteed bonds" and to "hold down . . . the cost of the assistance package to the taxpayers and the system as a whole." Conference Report, p. 186.

Certification is not a "technical issue" but at the core of the congressional bailout/oversight scheme. Without certification, the special oversight intended by the Act disappears, and all kinds of public purposes and protections are eliminated. Congress did not intend that institutions below the 75% threshhold could "pick and choose" at their own whim when they wanted to apply for certification. Congress purposely put these severely distressed institutions (those below the 75% threshhold) into a special category and mandated that they apply for certification. It also mandated that the Assistance Board act promptly on any application. Further, the terms of the section on "mandatory determination of eligibility" [SEC. 6.4(c)] indicate that approval of an application from one of these severely distressed institutions would and should be a foregone conclusion. Allowing the management of such an institution to pick and choose when it applies frustrates the whole point of the certification scheme. When an institution

violates the law by failing to apply for certification it unlawfully undermines several important objectives:

First, as stated above, an important part of the Assistance Board's job is to protect taxpayers by taking steps to prevent the need for federal financial assistance (through the issuance of preferred stock). An institution's refusal to apply for certification means taxpayers are being denied the federal oversight by the Assistance Board intended to assure that all forms of "non-cash" assistance are utilized before an institution must resort to the cash assistance available through the issuance of preferred stock. It also means that FCS stockholders outside the Omaha district could end up having to pay for special bailout assistance to the Omaha district.

Second, certification requires special district-level review of individual loans to determine whether to restructure the loan [SEC. 4.14C(a)]. A closely related right includes the mandated creation of a district-level "special asset group" to review denials of restructuring [SEC. 4.14C(b)].

Third, the Assistance Board's establishment of a "National Special Assets Council" to monitor the Omaha bank's implementation of debt restructuring will not be available to Omaha district borrowers without certification. [SEC. 4.14C(c)].

Fourth, certification of an institution triggers a national-level, multi-district compliance review of debt restructuring under SEC. 4.14C(c)(3). This scrutiny may be the only way to, at least, partially resolve different districts' contradictory interpretations of debt restructuring procedures.

Fifth, Congress and the public will be denied assess to critical Omaha bank information that is only available through certification by the Assistance Board [SEC. 6.6(d)].

Sixth, without certification beginning and re-entry farmers and ranchers will be denied the opportunity to participate in the "Demonstration project for purchase of system land." [SEC. 613(b) and (c)]. The new demonstration project extends the interest "buy-down" program, which was established through the efforts of the late Senator Zorinsky, and would make currently unused funds in that program available for interest assistance to family farmers to buy inventory property from the Omaha bank. This interest assistance is coupled with a 90% guarantee for the lender in return for a low 15% downpayment. (See attachments 4 and 5). The funding and loan guarantees are all in place, but because of the Omaha banks' refusal to apply for certification, Omaha district family farmers are denied access to the special terms. As a result, that pattern of inventory sales to investors and others who can pay cash or afford current high downpayments will continue across the midwest. Incidentally, the Jackson (Miss.) FCS bank (the one bank that has applied for and received certification) has enthusiastically endorsed the use of the demonstration project in its 3-state area (LA, MS, AL). (See attachment 6). At the end of December 1987 (our latest available data), there was about $140 million worth of property in the Omaha district that could be sold through the demonstration project.

Seventh, the stockholder-borrowers in the Omaha district are entitled

to, and need, the Assistance Board's special oversight that comes only with certification. Over the last several years, there have been many problems and abuses that, if identified and corrected by meaningful federal oversight, could have prevented the depths of the Omaha district's distress. For example, the liquidation of the Valentine and O'Neill PCA's and the "shotgun" association mergers of two years ago are part of the Omaha management's heavy handed legacy. Assistance Board oversight is a two-way street: it will facilitate borrowers expressing legitimate grievances in the implementation of the Act which in turn provides the regulator with an early warning system of abuse of the law.

Eighth, Omaha district stockholders, both present and future, will be denied the benefits of other Assistance Board general oversight powers including the Assistance Board's general mandate to take such actions as may be necessary to "establish prudent operating practices" and "return the institution to a sound financial condition." [SEC. 6.6(a)(10)].

The Omaha management's announcement yesterday (May 11, article attachment 7) of the proposed merger of the Omaha FLB and FICB provides an explanation of why the Omaha bank management has been providing misinformation and violating the new law for these last several months. I believe the Omaha management's plan is simply to forever relieve themselves of the required (and, by them, dreaded) Assistance Board oversight by trying to pretend that the law doesn't say what it says. I think it's a positive development, if true, that the Omaha FLB doesn't need to ask for federal assistance. But that fact, alone, is irrelevant to the purposes and standards of the certification scheme which placed the Omaha FLB under the legal obligation to apply for certification back in January because it was under the 75% threshhold.

I repeat, this is not a technical matter that becomes moot after the proposed July 6th FLBA-FICB merger. What's at stake is the loss of a whole set of congressionally established protections and benefits (described above) for taxpayers, FCS borrowers and farmers who are prepared to begin rebuilding family farm agriculture by farmland financing through the demonstration project. These protections and benefits should have been available months ago, and must be locked in place now, as the law clearly intended. The Omaha management's apparent plan to escape its new legal duties through the July 6th merger and permanently thwart the protections and opportunities described above. Time is of the essence, and we would ask you and other members of the 4-state congresional delegation to look into this matter. Thank you.

Sincerely yours,

Gene

Gene Severens
Staff attorney

cc: Congressional delegations from Nebraska, Iowa, South Dakota, Wyoming.
Eric Thor
Senator Patrick Leahy
Senator David Boren
James Kirk (Omaha FCS)
Rep. Kika de la Garza
Rep. Ed Jones

Attachments 1-7 follows:

Attachment 1

Farm Credit president visits state, gives no word on Omaha assistance

By Dan Looker
Journal Farm Editor

The head of a new federal agency established to provide financial assistance to the nation's Farm Credit System, would not comment Thursday on reports that the Omaha district of the system has applied for federal assistance.

Eric Thor Jr.

Other officials denied a report in the Wall Street Journal that the Omaha district has applied for the assistance.

Eric Thor Jr., president of the Farm Credit Assistance Board, was in Nebraska Thursday to review financial plans for the Federal Land Bank and to go over the methods that will be used to return $5.6 million in stock to borrowers of the Valentine and O'Neill Production Credit Associations.

The two PCAs closed in late 1984. But financially sound borrowers who went elsewhere for credit weren't able to get their stock in the two lending cooperatives returned until Congress passed the Agricultural Credit Act late last year.

"We're glad we could finally get this problem solved," said Thor, president of the board that was established to oversee financial assistance to the Farm Credit System, the nationwide network of lending cooperatives hit hard by the depression in the farm economy.

Thor was in Lincoln Thursday morning to meet with Gov. Kay Orr and other public officials. Later in the day he was to meet with officials with Farm Credit Services of Omaha, the regional bank in charge of PCA and Federal Land Bank Loans in its four-state district — Nebraska, Iowa, South Dakota and Wyoming.

Thor would not say whether Farm Credit Services of Omaha has applied for financial assistance.

"We are meeting on an ongoing basis with all banks that may qualify for assistance," he said. Thor said he would discuss the financial plans of the Omaha Federal Land Bank briefly with officials Thursday, but that the meeting was only a short courtesy call. More meetings will take place later, he said.

John Daubert, senior vice president of Farm Credit Services, said that the bank began last January to submit financial plans to the new assistance board. The plans are the first step in getting certification to allow the Omaha Federal Land Bank to receive financial assistance but "we're not even close to asking for financial assistance," he said.

If the value of Land Bank stock falls below 75 percent of it's $5 face value, the bank is required to seek certification, he said. The Land Bank's stock already is below that $3.75 trigger point, he said.

Bank officials said they do not believe the stock will need to be restored this year, for several reasons. One is that the federal bailout legislation that set up the Assistance Board also requires regional land banks and Federal Intermediate Credit Banks to merge by June 1. Daubert said that the merger with the stronger FICB will improve the land bank's financial condition.

"The rate of decline in stock value has slowed substantially and we think we've halted it," Daubert said. With an improving farm economy, the land bank could make money this year and that would also lower the need for a bailout.

If assistance is needed, the assistance board will provide funds to guarantee the stock at its $5 par value, he said.

"The ability to refund stock of the Valentine and O'Neill PCAs is an example of that guarantee," he said.

Note: Excerpt only.

Attachment 2

CENTER FOR RURAL AFFAIRS
Post Office Box 405
Phone (402)846 5428
Walthill, Nebraska 68067
Population 900

May 10, 1988

John Martin
Senior Vice President
Farm Credit Services
206 South 19th Street
Omaha, NE 68102-1755

Dear John:

I just wanted to confirm our conversation via telephone this afternoon. As I indicated to you, U. S. Senator Exon had invited me and some other farm group representives to attend a meeting last Friday with Mr. Eric Thor, president of the Farm Credit System Assistance Board. He formally acknowledged that the value of the stock of the Omaha Federal Land Bank was below the 75% threshhold established by SEC. 6.4(b) of the Ag Credit Act of 1988, and in answer to one of my questions, he formally stated that the Omaha Federal Land Bank had not applied for certification under that section. (In earlier press reports, he had refused to answer this question even though David Beeder's article in the Omaha World Herald implies that he was the source of misinformation about which districts had or had not applied for certification--enclosed articles).

You confirmed both Mr. Thor's statements to me in this afternoon's phone conversation that the Omaha FLB is below the 75% threshhold and that it had not applied for certification. I hope that fact is now firmly established--the Omaha Bank has not applied for certification. This leaves two unanswered questions:

(1) How does the Omaha Bank management explain its apparent unlawful noncompliance with SEC. 6.4(b):

> "If the book value of the stock . . . of a System institution . . . is less than 75 percent of the par value of the stock . . , the institution shall request the Assistance Board to grant certificiation . . ."?

This is a very mechanical formula, with little room for interpretation: either the Omaha FLB is below 75% or it isn't, and if it is (and everyone admits it is), it must apply. You responded that the Omaha FLB had "provided information" to the Assistance Board which disclosed your condition to the Board. But you referred me to an Omaha Farm Credit Service attorney when I asked whether the information you provided satisfied SEC. 6.4(b)'s requirement of an application for certification. I'd be happy to talk to him, but I think it's a cut-and-dried issue--either it is or it isn't an application for certification. Anything less than an application fails to comply.

(2) Why have Omaha officials been saying, as recently as March 24 (enclosed Lincoln Journal story) that the Omaha bank "began last January to submit financial plans to the new assistance board," and that "the plans are

Attachment 3

"Demonstration Project" Technical Hang-up

Section 613(c) of the Agricultural Credit Act of 1987 creates the "demonstration project for the purchase of system land." For a description of how the project works, see (or write us for) the Fall 1987 issue of the Advocate. Project implementation now awaits regulations, but in the meantime, a technical problem has developed.

The project is designed to limit participation to distressed FCS institutions defined by the statute as those that are "certified" by the new Farm Credit System Assistance Board to issued preferred stock. In other words, participation in the demonstration project is keyed into the financial bailout mechanism. Certification is basically a three step process:

Step 1: Distressed institutions apply for certification to the Assistance Board. Institutions with stock valued at less than 75% of par value must apply for certification. Those with stock valued under 100% but over 75% of par value may apply.

Step 2: The Assistance Board approves or disapproves the application for certification. The legislative history indicates that the Assistance Board is expected to certify institutions below 75%. A certified institution does not necessarily receive bailout funds (Step 3); but step 2 does invoke special powers of the Assistance Board over the certified institution. The legislative history also assumes that the Assistance Board will explore all "non-cash assistance" before resorting to the "cash assistance" of step 3. Use of the demonstration project is an example of non-cash assistance.

Step 3: This step is the government financial bailout. The Assistance Board determines that the certified institution needs "cash assistance" and authorizes the institution to issue preferred stock. This stock is bought by a newly created bailout entity (the "Financial Assistance Corporation") which raises funds by selling separate, taxpayer-backed bonds.

The management of many distressed institutions are apparently attempting to delay or avoid certificiation because they are apprehensive about being under the special powers of the Assistance Board. Even institiitions under the 75% threshold (see Step 1), are arguing to delay certification. This prevents them from participation in the demonstration project. Officials from one district bank have indicated they would like the option of using the project but not at the cost of being subject to the powers of the Assistance Board.

This result is illogical and unnecessary. It's illogical because the demonstration project goes untested while institutions interested in using the project can't because of unrelated fears of Assistance Board powers. The result is unnecessary because the newly created scheme provides adequate flexibility to avoid this problem.

As the legislative history shows, the certification process deliberately makes a key distinction between certification approval ("Step 2" above) and the issuance of stock ("Step 3") so that all "non-cash assistance" can be utilized to avoid the necessity of stock issuance. The Assistance Board has the authority and responsibility to avoid stock issuance by designing (and, as conditions change, altering) non-cash assistance: it can, among other things, encourage use of the demonstration project while at the same time explicitly refrain, at least temporarily, from the use of other more drastic methods.

There is no reasons that well-designed Assistance Board responses to certification requests cannot prescribe appropriate forms of assistance and relieve the fear that the Assistance Board is going to sweep in with its full scope of special powers. At any rate, for those institutions where stock has fallen below 75% of par value, they have already applied for certification and should quickly certify these institutions at least for the purpose of encourging use of the demonstration project. <>

Attachment 4

FCS REPORTER

FCS Inventory Re-Sale Program

Financing Family Farm Rebuilding

On December 16, 1987, Congress passed, and the president signed into law, the Farm Credit Act Amendments of 1987. One important, but little reported, provision of the law was the creation of a "demonstration project" for selling FCS inventory farmland to family-size farmers. This project, the result of the efforts of Senate Agriculture Committee Chairman Patrick Leahy (D. Vt.), would achieve a number of related public purposes:

--provide farmland purchase opportunities for beginning farmers and those who are expanding to family-size operations;

--provide immediate assistance to distressed FCS institutions by providing a new set of buyers for FCS inventory land;

--rejuvenate local associations' membership by providing a new set of potential family farm stockholders;

--help stabilize farm land values;

--rebuild family farm-based rural economies and prevent unnecessary out-migration of farm families;

--develop a new mechanism for encouraging appropriate conservation practices on FCS inventory land;

--demonstrate a different model for providing farm ownership credit that clarifies the limits of both the government's and the borrower's commitments and expectations.

At the heart of the program is a five-year period of 4% interest assistance from FmHA for eligible family farmers to purchase FCS inventory property. A 90% FmHA loan guarantee comes with the 4% interest write down, and the package is then linked up with a private lender or FCS institution which finances the land purchase. Qualifying farmers must make a 15% downpayment on the FCS land, and after 5 years, the borrower will be required to "graduate" to commercial financing.

The demonstration program would last for three years and require that the Farm Credit Administration and FmHA develop a joint memorandum on how to implement the program. FCS institutions would be authorized to sell $750 million worth of property through the program over the three-year period (FCS inventory is valued at $1.1 billion by the October Farmline magazine).

Required Graduation

Fiscal considerations made it imperative to consider an ending point for any federal interest assistance for targeting the sale of FCS inventory land, and required "graduation" to a commercial lender after five years. The borrower must refinance the loan at the end of the five years.

Graduation is also a part of direct FmHA programs, but it occurs "cold turkey" with little, if any, advance planning to make the transition easier. In the case of this special program, however, graduation should be feasible since other components of the program are designed to smooth out the transition from program financing to commercial credit. Where graduation is carefully planned for, it can both give participants realistic expectations and define the limits of the government's involvement in a loan.

This demonstration project contains a number of elements which make graduation feasible:

(1) The borrowers' fifth year equity position will rise from 15% (the downpayment) to over 28% during the 5-year period (see example below), placing the borrower's new equity position at the end of the fifth year within both current FCS limits and those legally required (20% minimum) for the proposed secondary market for agricultural mortgages. If land values appreciate, the borrower's equity position would increase even more.

(2) While it is difficult to predict interest rates five years away, based on today's rates, the farmer's effective interest rate will rise by approximately 5% after graduation. Assuming the refinanced loan were amortized over 30 years, the new annual payment would increase less than 11% (from $7411 to $8279, see example below).

(3) A five year record of debt payment and equity increase will provide an important indication to a commercial lender of likely continued success.

Will It Work?

A key question, of course, is will this program really be used? At least two recent federal credit programs, which relied on an FmHA guarantee to induce a partnership between the

to page 14

Attachment 5

Chicago Tribune, Friday, May 9, 1986 Section 1 21

Farm aid that isn't getting through

By Marty Strange

It must have been quite a spectacle. More than 200 investors assembled in Chicago's Bismarck Hotel one day in March to watch farmland sellers trot out their wares. Like used curiosities, parcels that once held the dreams of American farm families were offered for sale as bargains.

It was, of course, nothing more than what could be expected in the wake of the collapse in farmland values that has left agricultural lenders burdened with a huge inventory of land acquired from farmers unable to make mortgage payments. It was no surprise that the event was sponsored by the Chicago Farmers, an urban agribusiness club whose members might make lively bidders.

But it was a mild surprise that the fair was cosponsored by the St. Louis Farm Credit Bank, one of a dozen quasi-federal lending institutions that make up the borrower-owned farm credit system. These banks have over $1 billion worth of American farmland to sell, and seem in a hurry to sell it to nonfarm investors.

A year ago, Farm Credit Services of St. Paul, serving Michigan, Wisconsin, Minnesota and North Dakota, shocked observers with full-page ads urging investors to "Buy North Dakota," at least that part of it acquired by the St. Paul bank from broke farmers. As an encore, the bank this year started selling farms to investors in bulk. In an outrage not likely to be topped soon, 133 Minnesota farms totaling 20,761 acres in 29 counties were sold to one limited partnership for $13.5 million, before the Minnesota legislature broadened restrictions on corporate farming to include limited partnerships.

This behavior shows arrogant disregard for the spirit of legislation passed last year to bail out these troubled farm credit banks. Congress offered a $4 billion aid commitment, but included a requirement that the banks offer to sell farmland back to the farmers who lost it. Short-circuiting those borrowers' rights might eventually thwart the St. Paul bank's bulk sales.

Anticipating that many farmers would not be able to buy their land back, Congress went further to assure that the land not fall into the hands of speculators. Under a special "demonstration" project, a five-year federal guarantee is available for financing the sale of inventory land owned by a farm credit bank in need of special federal assistance. Either the farm credit bank or a commercial lender can finance the sale and qualify for the guarantees, but the loans must go to beginning or other family farmers who would not qualify for commercial credit otherwise. The farmers would have to put only 15 percent down (compared with 40 to 50 percent banks ordinarily get from investors) and would get a 4 percent interest subsidy from the government for five years, after which they would have to refinance at regular commercial rates.

Congress has authorized enough guarantees and interest assistance to sell up to three-fourths of the farm credit banks' farmland inventory this way, and the administration has set aside the necessary funds to make the program work. In short, a policy is in place to repopulate American farms and rural communities with real farmers.

Why, then, bulk land sales to limited partnerships and downtown Chicago investor fairs?

The driving force behind these sales is probably bank managements' fear of the consequences of the federal oversight accompanying any form of federal bailout. Engaging in bulk sales to investors may be no more than a self-serving attempt by management to raise some cash to delay federal oversight.

To qualify for federal assistance, including participation in the land sale demonstration project, a farm credit system institution must apply for certification with a new federal Assistance Board, which has broad powers to regulate certified institutions. Management staffs of some banks apparently are willing to disregard clear public policy in selling inventory land to avoid federal oversight.

Although several banks are in enough trouble to qualify for certification and participation in the demonstration project, only one—serving Alabama, Louisiana and Mississippi—has actually requested and received it. Interestingly, this bank determined that the land sale demonstration project would be extremely beneficial, and the bank quickly volunteered to use most of the funds available for the project.

The demonstration project has the potential for creating 7,000 new farming opportunities across the country. Congress did not intend for the benefits to be concentrated in one farm credit bank, but assumed that all of the hard-hit farm states would participate.

Fortunately, there is an easy remedy. The Assistance Board can use its power to expedite the certification process and clarify the relationship between participation in the demonstration project and the dreaded certification (which triggers federal oversight). The board can include participation in the demonstration project as part of a tailor-made assistance plan.

For example, for moderately distressed farm credit banks, the board can issue special certification to participate in the demonstration project without necessarily invoking a full range of federal oversight. For severely distressed institutions, the law assumes that certification is a foregone conclusion, and the board should prescribe as much oversight as necessary to stabilize the institution. In either case, participation in the demonstration project is desirable. It can convert unwanted inventory property into low-risk performing loans and provide future full-fledged borrower-members in the cooperatively owned farm credit banks.

The prospect of losing the owner-operated farm to absentee investors is not welcome. Permanent tenancy invites the farmer to farm only for immediate cash income, and passive ownership invites the wary farmland investor to care not for the land but only for its value. It is not unrealistic to expect that soil erosion, groundwater pollution and other degradations will increase as the ownership of farms becomes more remote from their operation.

But absentee ownership of farmland is not inevitable. The "woe is me" part of the farm crisis is over. Land values are recovering, there are bargains in the market and an opportunity to do something meaningful to revitalize family farms. Congress wisely anticipated the need and provided legislation. Only timidity, cynicism and an open disregard for the objective of that legislation stand in the way.

Attachment 6

March 22, 1988

FmHA DEMONSTRATION PROJECT

The Farm Credit Legislation of 1987 included an FmHA Demonstration Project that would allow eligible FmHA applicants to purchase Farm Credit System acquired properties. Terms are understood to be that with a 15% down payment on the purchase price of the land at fair market value and meeting all conservation requirements, the borrower can receive a 4% interest rate reduction from the lender on a 90% guarantee up to the first five years. If the lender is willing to reduce the interest rate by at least 1%, the lender can be eligible for a 95% guarantee of principal and interest. This means that a farmer can purchase acquired property of the Federal Land Bank and/or Production Credit Association in this district at fair market value, and if the institution's interest rate is 11%, the farmer can get financing for 7% for the first 5 years. If the lender will write down 1% more, the borrower can get 6% for the first five years. (This rate will depend on the cost of funds at time of loan closing.) The lender in return can obtain a 90% or 95% guarantee of principal and interest on a new accruing loan. The FmHA will also reimburse the lender for the 4% interest that has been reduced.

What does this mean to the Fifth Farm Credit District located in Jackson, Mississippi which includes the states of Alabama, Louisiana and Mississippi? The PCA has approximately 34 properties valued at $2,108,308 comprising 3022 acres. The FLB has approximately 408 properties valued at $93,709,000 or 163,262 acres. Although the PMM financing package has been and is successful at removing properties, the FmHA project has these advantages:

1) Interest rates for the first 5 years are 3 to 4% lower than PMM financing.

2) Borrower's down payment is 5% less.

3) Percentage of fair market value can be obtained thus keeping land values more stable.

4) The lender obtains a 90% to 95% principal and interest guarantee on the loss exposure of the loan. This projects a cleaner loan portfolio if adversity should occur, thus limiting necessary loan loss reserves of the institutions. It also can be used as a hedge against falling land values if the cycle should turn around during the loan period.

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Omaha Farm Credit's positive earnings first since '83

By Dan Looker
Journal Farm Editor

In the first quarter of 1988, all three banks of Farm Credit Services of Omaha reported positive quarterly earnings for the first time since 1983, bank officials said Tuesday.

The Federal Land Bank of Omaha, which makes long-term loans to buy farmland through local federal land bank associations, earned a net income of $21.4 million during the first three months of the year for the land bank and the associations.

Omaha's Federal Intermediate Credit Bank, which makes loans for operating expenses and farm machinery through the Production Credit Association of the Midlands, reported combined income for the two short-term lenders of $4.2 million.

The Omaha Bank for Cooperatives, which lends to farmer-owned cooperatives, reported earnings of $1.6 million.

The three banks do business in Nebraska, Iowa, South Dakota and Wyoming — the Omaha district of the nation's largest agricultural lender, a network of cooperatives known as the Farm Credit System.

And, like the Omaha district, the national system reported an improving financial situation Tuesday, with first-quarter earnings of $185 million. A year ago the system lost $155 million in the first quarter.

Reflect accounting

The Omaha Federal Land Bank's earnings are a reflection of accounting as much as a real increase in business — $36 million in new loans during the first quarter compared with $10 million during the first quarter of 1987, said Jim Kirk, president of Omaha Farm Credit Services.

Because other land bank borrowers either reduced their debts or went out of business, the total loan volume for the land bank was almost unchanged from the end of 1987 — at $3 billion on March 31.

The real change for the land bank came from an improving farm economy and higher land prices that allowed the bank to cut its provision for loan losses by almost $30 million. The provision is an accounting procedure that sets aside a reserve for future loan losses.

Farm Credit Services' efforts to rewrite borrowers' loans and to sell 199,200 acres of acquired property during the first quarter also helped improve the land bank's financial position.

"Without those non-recurring events, we would have had a loss," Kirk said in a telephone interview from Scottsbluff, where he was meeting with bank officials. "The land bank will be profitable from an operating standpoint in the late part of 1989."

Assistance not needed

Kirk and other bank officials also expect they won't need federal financial assistance available from a Farm Credit System bailout passed by Congress late last year.

Under the law, the land bank already qualifies for assistance because the worth of stock held by borrowers has fallen to less than 75 percent of its $5 per share face value. The stock is currently worth $1.63 per share, said John Daubert, senior vice president of Omaha Farm Credit Services, up from $1.14 per share at the end of 1987.

But the same law that provides assistance to troubled Farm Credit System members also requires district federal land banks and federal intermediate credit banks and affiliated PCAs to merge. When that happens, the more valuable PCA stock, worth $7.16 a share, will help bring the land bank stock value above the $3.75 level that qualifies the bank for federal assistance, Daubert said.

"From our standpoint, we won't need federal assistance. We've stabilized the situation and look forward to a brighter future," he said.

Stock guaranteed

The law also guarantees farmers' stock in their land bank associations and PCAs at the full $5 per share value. That's another important factor in stopping the flight of borrowers from the system, bank officials believe.

"If we continue to increase the new loan volume, we'll be making substantial strides at increasing market share," Daubert said.

In the Omaha district, the land bank once held about 30 percent of all farm real estate debt. Now its share is about 23 percent, with the rest held by banks, insurance companies, the federal government's Farmers Home Administration, and individuals who sell land on contract. The district's PCAs once held up to 20 percent of the short-term debt. Now that's between 5 percent and 10 percent, Daubert said, with commercial banks holding the rest.

Nationally, the Farm Credit System's total outstanding loans rose from $52.5 billion at the end of 1987 to $52.8 billion on March 31, according to a report released Tuesday by the Federal Farm Credit Banks Funding Corp. in New York City. Earlier in the decade, the Farm Credit System held about $80 billion in loans, more than a third of the nation's total agricultural debt.

Attachment 7

PATRICK J. LEAHY, VERMONT, CHAIRMAN
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United States Senate
COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

May 25, 1988

The Honorable J. James Exon
United States Senate
Washington, D.C. 20510

Dear Jim:

Thank you for your letter concerning the implementation of the Agricultural Credit Act of 1987 in the Omaha Farm Credit District. You have raised some excellent questions and I appreciate your bringing them to my attention.

Your questions relate specifically to the so-called "assistance provisions" of the Farm Credit Act of 1971, as amended. Under the Act, upon the impairment of any stock (including participation certificates and other similar equities) in a System institution, the Farm Credit Administration is required to notify the Assistance Board of such impairment and the Assistance Board is required to monitor the financial condition, business plans, and operations of the institution. (Impairment of stock occurs when the book value of stock, based on generally accepted accounting principles (GAAP), is less than par value.)

A System institution may request certification if the book value of its stock is less than par value. However, once the book value of stock is less than 75 percent of par value, a System institution is required to request certification for the issuance of preferred stock. Section 6.4(b) of the Farm Credit Act is very clear in this respect. As I understand the situation in the Omaha District, the Omaha Federal Land Bank is in violation of section 6.4(b) of the Act if it has not requested certification. Since the regulator of the Farm Credit System is the Farm Credit Administration, it is the Farm Credit Administration's responsibility to ensure compliance with the Farm Credit Act. The Farm Credit Administration has ample enforcement powers under the Act to ensure compliance. The Assistance Board has no power over an institution until that institution requests certification.

Section 6.4(c) of the Act requires the Assistance Board to determine whether to certify a System institution if (1) the institution requests certification; (2) the book value of the institution's stock has declined to 75 percent of its par value; and (3) the institution agrees to meet the terms and conditions specified by the Assistance Board. Under the statute, an institution must agree to the terms and conditions of the certification before it can actually be certified.

Under section 6.5(c) of the Act, if the Assistance Board certifies the institution, the Board is required to authorize the institution to issue preferred stock in an amount sufficient to maintain the value of stock at not less than 75 percent of the par value of the stock and sufficient to strengthen the institution to a point where it is economically viable and capable of delivering credit at reasonable and competitive rates. As stated in the Conference Report, it was the intent of the conferees that cash financial assistance to System institutions would be provided no later than when stock falls to 75 percent of par value unless the Assistance Board has decided to facilitate a merger or that it is less costly to liquidate the institution and has recommended such liquidation to the Farm Credit Administration. As this applies to the situation with the Omaha Federal Land Bank, if the Federal Land Bank requested certification, the Assistance Board would be required to immediately determine whether to certify the Bank, facilitate a merger, or request the Farm Credit Administration to liquidate the Bank. If the Assistance Board decided to certify the Federal Land Bank, the Board would be required to permit the issuance of preferred stock in an amount sufficient to ensure that the value of stock was no less than 75 percent of par.

As you state in your letter, the request for certification and the certification itself results in several oversight responsibilities. Several broad powers are granted to the Assistance Board with respect to institutions that request certification. These powers provide the Assistance Board with prior approval authorities over the institution's business plans, operating policies, debt issuances, and specified personnel matters. In addition, the Assistance Board can, under certain circumstances, direct the Farm Credit Administration to appoint a conservator or request that the Farm Credit Administration appoint a receiver for the institution. The Assistance Board can also require the institution to obtain approval from the Board before setting

the terms and conditions of any debt issuances of the institution. Further, the Assistance Board can request that the Farm Credit Administration exercise its statutory authorities to approve or require a merger of the requesting institution with another System institution. Certified System institutions are also required to implement specific loan restructuring provisions. Once certified, these institutions have nine months to review previously unrestructured nonaccrual loans to determine if they should be restructured. After these loans are reviewed by the institution, any decisions to restructure will also be reviewed by the district Special Asset Group. Compliance by certified institutions and district Special Asset Groups will be monitored by the National Special Asset Council established by the Assistance Board. The district review and national monitoring are internal processes to assure that System institutions receiving assistance are meeting the debt restructuring provisions of the Act.

In your letter, you expressed concern about the possible effect that noncertification of the Omaha Federal Land Bank would have on the Federal Intermediate Credit Bank. As you know, the Agricultural Credit Act of 1987 requires each Federal Land Bank to merge with the Federal Intermediate Credit Bank in the district by July 6, 1988. Upon implementation of the merger, the Assistance Board is required to provide the new Farm Credit Bank with financial assistance sufficient to ensure that its stock is equal to 75 percent of par value. Without knowing the specific financial conditions of the Omaha Federal Land Bank and the Omaha Federal Intermediate Credit Bank, it is impossible to know the result of the merger on the Federal Intermediate Credit Bank. However, one could assume that the merger would lower the overall position of the Federal Intermediate Credit Bank since the Federal Land Bank's stock is below 75 percent of par value and the Federal Intermediate Credit Bank's stock is above 75 percent of par value. It is possible that the value of the new Farm Credit Bank's stock would be less than 75 percent of par. If that were the case, the Assistance Board would be required to direct the Financial Assistance Corporation to provide the Omaha Farm Credit Bank with assistance sufficient to ensure that the stock of the Farm Credit Bank had a book value equal to 75 percent of par. If the Federal Land Bank were certified prior to the merger, the Assistance Board would be required to bring the value of its stock up to 75 percent of par value, as described above. Obviously, the value of the new Farm Credit Bank's stock would be higher under this

scenario since the value of the Federal Land Bank's stock would be higher at the time of the merger.

Finally, you asked if adverse actions taken by the Federal Land Bank during the period of time in which the Bank is in violation of section 6.4(b) of the Act would be subject to legal challenge if a court found that the Federal Land Bank was in fact in violation of the Farm Credit Act of 1971. Without knowing the specific circumstances of any given case, it would be difficult to give a definitive answer to this question.

I hope this sufficiently addresses your concerns. On June 16, the Subcommittee on Agricultural Credit will be holding a hearing on the implementation of the Agricultural Credit Act of 1987 as it relates to the Farm Credit System. It will be good to discuss the issues raised in your questions at this hearing.

Let me know if I can be of further assistance.

Sincerely,

David L. Boren
Chairman
Subcommittee on Agricultural Credit

DLB/ke

OVERSIGHT ON THE IMPLEMENTATION OF THE AGRICULTURAL CREDIT ACT OF 1987

With Respect to the Farmers Home Administration

FRIDAY, SEPTEMBER 30, 1988

U.S. SENATE,
SUBCOMMITTEE ON AGRICULTURAL CREDIT OF THE
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:50 a.m., in room SR-332, Russell Senate Office Building, Hon. David L. Boren (chairman of the subcommittee) presiding.

Present or submitting a statement: Senators Leahy, Boren, Harkin, Conrad, and Daschle.

STATEMENT OF HON. DAVID L. BOREN, A U.S. SENATOR FROM OKLAHOMA

Senator BOREN. I think we will begin.

As you know, today's hearing is going to focus on the Farmers Home Administration's implementation of the Agricultural Credit Act of 1987. We are honored to have the chairman of the full committee here with us this morning, and before I make my opening comments, I would like to defer to him for his opening remarks.

Chairman Leahy, we are really pleased to have you with us this morning. This signals your interest and your feeling that the proper implementation of these regulations is a matter of great importance and we are glad to have you with us.

STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM VERMONT

The CHAIRMAN. Thank you, Mr. Chairman.

I, again, as I have before, want to compliment you for the way you have run this subcommittee. Not only in your own State of Oklahoma, but also in my State of Vermont, Farmers Home Administration policies are very important. I think it harkens back not only to the oversight you have had at Farmers Home but the work you did in helping us put together the farm credit bill last year. People supposedly in the know said it could not possibly be done in one year, but the President was able to sign it by Christmas. I know he complimented you, me, Dick Lugar and the other members of the committee.

I appreciate your courtesy in letting me step first so I can get off to a doctor's appointment. I am very concerned about comments

that have been attributed to the Farmers Home Administrator, Mr. Clark, before the Downtown Rotary of Madison, Wisconsin.

I assume that when the Farmers Home Administrator is out going around the country, he is doing it to help out Farmers Home, and Lord knows, with some of the problems they have, they need everybody possible. It appears instead he took time off to give what I thought was a most amazing, off-base and completely unfounded political speech.

He is quoted as saying that Farmers Home is being forced by the "liberal legislators" toward "socialism." He said that Farmers Home policies are typically shot down by liberal Members of Congress who head key committees and are beholden to special interest groups.

And he is quoted as saying, "These liberal policies will lead to socialism unless we do something about it."

Now, since I have been chairman of the full committee, the only legislation passed that forces Farmers Home to do anything is the Agricultural Credit Act of 1987. Among the key "liberals" forcing that would be you, Senator Boren, as chairman of the subcommittee. I know that Senator Helms voted for it; Senator Lugar voted for it; Senator Boschwitz voted for it on the floor of the Senate; Senator Quayle, that noted liberal, voted for it.

This kind of foolishness is unacceptable. The Farmers Home Administration is designed to be nonpartisan and nonpolitical and is supposed to provide aid to farmers in this country. This kind of sloganeering, because all of a sudden we are going to attack liberals, as the issue of the week is wrong. To take Farmers Home and inject it into the campaign, I think is demeaning to Farmers Home and it is demeaning to see the Director doing it, and I think it is wrong. Of course, it is totally inaccurate to say that the liberal policies that affected the Agricultural Credit Act of 1987 is forcing this kind of activity.

Again, I would point out that the act was voted for in this committee by every single member. Of all the committees in the U.S. Senate, this one probably has the broadest ideological range and geographical range of any committee, and we voted unanimously.

We go across the spectrum from conservatives to liberals and moderates in this committee.

President Reagan signed the bill. In fact, I received a very nice letter from him afterwards complimenting the committee and the bipartisan leadership of the committee, Republicans and Democrats who joined and worked very, very hard together on that bill. And I don't think the President is leading us down the path toward socialism.

Now, everybody in this committee supported it. The President supported it. The Vice President supported it, and so I would hope that somehow, Mr. Clark, you are not trying to include them in your criticism. I don't think it sounds very much like a socialist plot to me, unless somehow the President and the Vice President and Senator Helms and Senator Dole, the Republican leader, and everybody has been drawn into it.

Now, I chair a key committee in this Congress, one that has oversight over agricultural policy. I don't feel beholden to special interest groups. I am interested in helping family farmers who are tem-

porarily down on their luck and need a loan so they can be back in business next year and pay back what they owe. So I think you are seriously misreading the Agricultural Credit Act. It was written to allow Farmers Home to convert nonperforming loans into paying assets. The law says that you cannot restructure loans for delinquent borrowers unless the net return to the Government at least equals what you would collect through foreclosure.

That sounds to me like not only good business sense, but it is also something that keeps people in farming. That, also, is what the Farmers Home is supposed to do. If it is not, then get rid of Farmers Home and just go to commercial banks. But so long as we are going to have it and so long as the President supports that, the majority of Congress supports having a Farmers Home, let's let it do what it is supposed to do.

My suggestion would be, there are enough people in elective office in both parties that are out doing the campaigning this year. Let them do it and you tend to Farmers Home. That is the job you are supposed to do. Lord knows you need every hand you can have down there. Maybe you should forget the political rotary club speeches and probably spend the time in helping to do the paperwork in the local Farmers Home office.

Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR DAVID L. BOREN

Senator BOREN. Thank you very much, Chairman Leahy.

As you indicated, today's hearing will focus on the Farmers Home Administration implementation of the Agricultural Credit Act of 1987. Full implementation of the 1987 act is critical. Many borrowers have already regretfully encountered adverse actions by other creditors due to the Farmers Home Administration inability to write-down loans until the regulations were issued. Hopefully these unfortunate situations will not be occurring again.

While it has taken the Farmers Home Administration longer than we anticipated to prepare the regulations, I am generally pleased with the apparent progress that has occurred between the issuance of the proposed regulations earlier this year and the issuance of the interim final regulations this month. I think we have seen some progress and some substantial improvement.

I am also pleased that the regulations were issued as interim final as this will ensure that all interested parties will have an opportunity to comment on the regulations as they are being implemented.

I want to say that I also share the concern that Chairman Leahy has just expressed a moment ago about statements attributed to the Administrator and I hope he will touch on them during his testimony. Perhaps he was misquoted—I hope he was—that the Agricultural Credit Act of 1987 was an attempt by liberal legislators to push the agency toward socialism.

Let me say, this is kind of a unique experience for me. I have never been accused before of being liberal. In fact, I sometimes have to defend myself to the degree that I am not liberal enough. Nor have I ever been accused of being partisan before, so this is a new experience for me.

Since I chaired the subcommittee that wrote this legislation, I would like to know if the Administrator was referring to me and to Senator Boschwitz, our ranking minority member, or the members of this committee who passed it unanimously, or to such noted liberal organizations as the Farm Bureau that worked very closely with us on this matter, and, of course, strongly endorsed it. I don't know to whom he was referring and I am very disturbed by this statement.

We had about 100 hours of markup on this legislation. We had more discussion with the Administration than I think has ever been had by a congressional committee writing legislation. We had completely open discussion between all members of this committee without regard to party label or ideology and we worked out, I think, a model of consensus building on a bill that could have been highly divisive and was, as we began to deliberate upon it.

Everyone acted in good faith and I think instead of going around the country lambasting this kind of action when Congress and the Administration get together and work together, when bills are passed unanimously by committees, virtually unanimously on the floor, when partisan politics is put aside and people work together in a constructive way. I thought that was what we are all about in this country. That is what I preach in the Intelligence Committee as well, which I also have the privilege of chairing. That is what a lot of other noted leftists such as Senator J. Bennett Johnston, chairman of the Energy and Natural Resources Committee, and Senator Sam Nunn, chairman of the Armed Services Committee, and others that I suppose you might have been referring to have tried to practice.

In fact, I have condemned partisanship over and over again and I must say that I hope that there is an explanation for these remarks, that they were not meant to apply to this piece of legislation, this subcommittee or this committee, because they do cast doubt about the act if it is viewed in that way by the Farmers Home Administration. This act had, as we have said, the broad support of both parties on this committee and the support of the White House and the support of major farm organizations all over the political spectrum.

If that is the view, then it would cast into doubt how serious the Administrator's intentions are to fully implement the act. I would be very disappointed if there is not a full intention to implement this act and if the Administration does not believe in this act, because I thought that they did.

We all worked too hard to make it happen so I think we need to be very careful. This could be a signal that the Farmers Home Administrator and county supervisors across the country, that they should not pay attention to this law or to the regulations. I hope that is not the case and I hope the Administrator today will take advantage of the opportunity to clearly affirm that he supports the law and that he intends to carry out the spirit of law, and that these regulations are not simply for a paper effect but they also intend to very strongly send a message to county supervisors across this country that they want the spirit of the law carried out at the local level.

I think it is important for all of us to remember that the 1987 act is not going to force the Farmers Home Administration to lose additional money. In my opinion, the policies of the past caused them to unnecessarily lose money in delaying and not restructuring loans that would have minimized losses. Restructuring of farm loans is required only if it is less costly to the Government than foreclosure. The 1987 act was necessary because the rigid rules of the Farmers Home Administration in the past often resulted in the Government sustaining a far greater loss through foreclosure than that which would have occurred had the loans been restructured.

So quite the contrary, this bill is an effort to save money for the Farmers Home Administration, save money for the taxpayer and preserve the asset value of the land base of the country and to help agriculture, of course, as well, by stabilizing the System.

The Agricultural Credit Act of 1987 simply requires the Farmers Home Administration to do what commercial bankers have been doing for years—restructuring loans when that is cheaper than foreclosure. I would hardly call that socialist legislation. It is modeled on what the private sector has been doing all along and it is simply asking the Government to have the common sense to follow these same policies.

I appreciate the willingness of the witnesses to testify this morning and welcome them.

Several people were unable to be present this morning because of a lot of other things going on, so we are holding the record open for several days for anyone or any farm organizations that wish to submit written testimony, as some have indicated to me that they would like to do.

I would like to turn to other members of the committee for any opening remarks that they might like to make. Senator Harkin, I believe you were here first so I will turn to you first.

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA

Senator HARKIN. Thank you very much, Mr. Chairman. Without treading over already plowed ground regarding the comments on socialism, I will just let those stand. Perhaps Mr. Clark would like to define what he means by socialism when he comes to testify here today. I would like to hear just what he means by that. Perhaps he has a different view of socialism from what is the normally accepted view of it.

I want to turn to a couple of other things, Mr. Chairman, and sort of pick up where you left off.

It seems that the Administrator of Farmers Home, Mr. Clark, has been going around the country, or issuing press releases from his office, talking about all the money that restructuring is going to cost the taxpayers. First of all, this spring it was $8 to $9 billion, now it is $2 billion. I don't know what it is. It is either $8 or $9 billion, or it is $2 billion, or somewhere in between, that he is saying it will cost the taxpayers and that we are going to lose all this money.

Well, the fact is, the debt is already there, as you pointed out, Mr. Chairman, and what we have to ask ourselves now, and not in an ideological manner, but in a very practical approach, what is

92-681 O - 89 - 20

the best, cheapest, and most effective way of dealing with that debt load? It is just like when we debated the mediation provisions of the act. The normal response I heard from the Administration, from Mr. Clark's office, was foreclose, put them through bankruptcy, even though that costs more money—and it has been proven to cost more money—than going through mediation.

Mediation saves money when it is used. So it was an ideologically rigid stance that the Administration took—if you have a debt and cannot pay it, go into bankruptcy. It almost seems to me that Mr. Clark, from what I have been reading in these press items—he can explain it when he gets up here—wants to reinstitute a debtor's prison. Once you are in debt, if you cannot pay it, you go to jail, or if you are in debt, take bankruptcy and don't do anything else.

The attitude of the Farmers Home Administration has not improved over the last year. I thought after we passed this credit bill, maybe it would change a little bit, maybe we would see a bit more practical attitude at FmHA, a little bit more of an attitude of trying to work problems out on a practical basis. But it seems to me the ideology still reigns down there.

Mr. Chairman, look at this. Remember when President Reagan spoke to the joint session and he plunked down this big pile of papers last year and made a big deal of it. Here are 160 pages of regulations on the credit bill. Well, that is 160 pages, plus 5 more on mediation, and there maybe some more that I haven't even dug up yet; 160 pages. The Omaha Farm Credit Bank used 2 pages to implement their debt restructuring policy—2 pages. We have 160 pages here of regulations. Talk about a bureaucracy pumping out the paperwork. They are more interested in putting out paperwork than they are in trying to help farmers; 160 pages of regulations to implement the credit bill.

It is like I pointed out, Mr. Chairman, last week, that in Iowa we have lost a lot of farmers over the last few years, but the personnel in our ASCS office has gone from 1,100 to 1,900, more bureaucrats, fewer farmers. We passed, I think, a credit bill that was pretty stripped down, a pretty straightforward credit bill, and we have 160 pages of regulations to confuse and muddle the whole thing up.

I defy anyone to go through those 160 pages in any kind of a rational way and make any kind of sense out of it. The FmHA State offices don't have the personnel to do it. I doubt if FmHA has the personnel downtown to do it. But that is the kind of thing that we are getting out of the Farmers Home Administration right now.

So it seems to me, Mr. Chairman, that the attitude of the Farmers Home Administration and of the Director, Mr. Clark, is the problem. Unless he can explain some of these press releases—maybe these are wrong, I don't know. But I see these regulations. I see the foot dragging on things like mediation. I see the foot dragging on things like the demonstration project. We worked long and hard to get this demonstration project in there for Farmers Home to help farmers buy inventory land of the Farm Credit System. We put money in there for it. To this day not one single property has been sold through the demonstration project; not one single property, and we have had the bill since January.

And then I see that FmHA is taking land it holds—inventory land—and qualifying it as surplus land rather than suitable land.

Well, what does that little phrase mean? Well, it means that if they qualify it as surplus land then they can sell it to anybody. They can sell it to investors, they can sell it to anyone. If it is suitable land, they have to sell it to farmers, family farmers. So what we are seeing—and I have the data here and I will put it in the record, Mr. Chairman—of the breakdown in the number of States here; U.S. total, I have here 1,913 properties, suitable properties, 1,074; surplus properties, 738. Of the total number, almost 40 percent classified as surplus land, which they can then sell to investors rather than to the farmers themselves, or to the families that were on it or family farmers.

[The material follows:]

HIGH VOLUME OF 1988 INVENTORY SALES

Farmers Home Administration data for fiscal year 1988 shows a high rate of sales from FmHA inventory (1913 sales through August 31, 1988) that is running nearly 25 percent ahead of sales for fiscal year 1987 (1649 sales). The bulk of the fiscal year 1988 sales (approximately 1480) took place after the January 14, 1988 "freeze" on sales of inventory properties. The states with the highest levels of sales activity so far in fiscal year 1988 are listed below.

[Dollar amounts in thousands]

	Total sales	Suitable sales	Surplus sales	Total value of sales
1. Missouri	381	283	75	$27,152
2. Iowa	182	170	9	14,046
3. South Dakota	116	88	27	8,260
4. Kansas	114	39	66	8,775
5. Tennessee	98	55	38	6,152
6. Arkansas	73	31	34	4,650
7. Idaho	69	18	48	5,080
8. North Carolina	64	27	32	5,752
9. Miss	59	17	41	3,853
10. Oklahoma	59	35	21	5,895
Total, United States	1,913	1,074	738	153,333

Source: Farmers Home Administration and FmHA National Summary Farmer Program Inventory Property Sales Activity as of Aug. 31, 1988.

Senator HARKIN. So again, an ideological attitude at Farmers Home Administration stands in the way. Obviously, they still want to get rid of Farmers Home Administration. Obviously they want to make the credit bill unworkable, almost unintelligible, with all of these regulations. The State FmHA offices are not getting the kind of directions they need, and I would point out right here that I believe the director in Iowa has done a good job. We have done a good job in Iowa. We have been forthright in this and we have been pushing ahead on it. But I will tell you, that is not what I see happening nationwide.

I would just close by noting that Mr. Clark, in his press release said that Farmers Home Administration had been loaning out all of this bad money. Mr. Clark said the agency has made noncollectible loans for too long.

Well, I would point out that since the 1930's Farmers Home Administration has pumped some $150 billion into the rural economy, not only through farm loans but rural economic development pro-

grams, housing, community and business loans. FmHA has done a great job out there helping our small towns and communities, including rural water systems and other programs to make life a little bit better for people in rural areas. And now we have in this country the best and most productive agricultural system this world has ever seen. And at the same time that money has been paid back. It is only in the last few years because of the stress in agriculture that we do have these uncollectible loans.

But Mr. Clark, don't feel too badly that you have however much it is out there—$20 some billion, you say, out there over all these years. I just saw in the paper this morning, Mr. Chairman, we are going to need $50 to $100 billion to bail out the S&L's in this country; $50 to $100 billion.

Now, what are we going to do? Are we going to put the S&L's in debtor's prison too? Are we going to take all their debts and pile it up and say after a certain period of time you have more debts going on out 30 or 40 years? We wanted this FmHA restructuring to end after 10 years. Now what it looks like FmHA is telling these farmers that after 10 years we are going to reschedule that debt and keep them in debt for another 10 or 15 years beyond that.

Well, I look forward to hearing from Mr. Clark and hearing his explanations of socialism and why we have 160 pages of regulations when the Omaha Farm Credit Bank can do it in 2 pages.

Two, Mr. Chairman.

Senator BOREN. Thank you, Senator Harkin.

Senator Conrad, any opening comments.

STATEMENT OF HON. KENT CONRAD, A U.S. SENATOR FROM NORTH DAKOTA

Senator CONRAD. I do, but perhaps Senator Daschle should go first since I am not formally a member of the subcommittee and I am here at the sufferance of the subcommittee.

Senator BOREN. I think the amount of work that you put in on this legislation entitles you to be an honorary member. In fact, you have worked so hard on it, I had forgotten you weren't officially a member.

Would you like to make some comments?

Senator CONRAD. Well, I would, Mr. Chairman. I thank you very much and thank the other members of the subcommittee for allowing me this opportunity.

We have introduced, as you recall, FmHA provisions which became the core of what was ultimately passed, so I, too, was somewhat nonplussed at the comments and I hope very much those are misquotes. You know that sometimes happens.

Most of my concern, Mr. Chairman, with this hearing are questions on the speed or the lack of speed with which regulations have been made available on the Agricultural Credit Act that was passed, after all, last year.

In every single community forum I have had this year—and I have had many all across the State—I have been asked, why aren't those regulations available? Other creditors are being delayed, and in fact, farmers are being foreclosed on by other creditors because

the FmHA write-down is not being allowed to occur. Farmers do not have available to them the relief that Congress had intended.

A second comment that I wanted to make along the lines of what Senator Harkin indicated, is a disturbing, I think, indication from the Department that was made to the American people that we are writing off $8 billion. That this was an action of Congress and that the money would have been collected had we not written the agricultural credit bill.

That is sheer nonsense. I asked the GAO for a report in May of this year and that report, entitled "Farmers Home Administration Farm Program Debt Delinquencies and Loan Losses as of June 30, 1987," makes very clear that FmHA had over $6 billion in loans that was 3 years delinquent or more.

Now, anybody who has been in the collection business—and I have been in the collection business, I was tax commissioner for my State—knows that when you are more than 3 years delinquent, you can forget collecting the vast majority of that money, and Vance Clark testified to that himself in hearings before our committee.

A third area of concern that I hear frequently when I am at home is the way the Agricultural Credit Act is being interpreted, that the will of Congress is being defied and that it is being made as difficult as possible for people to jump through the hoops in order to qualify. I hope, Mr. Chairman, that we are able to investigate that this morning.

Thank you for the opportunity.

[Material for the record follows:]

FmHA OVER-3-YEAR DELINQUENCIES OF MAJOR FARM PROGRAM DIRECT LOANS, JUNE 30, 1987

State/territory	Over-3-year delinquent dollars[a] (millions)	Outstanding principal owed by over-3-year delinquent borrowers[a] (millions)
Alabama	$ 87.3	$ 90.5
Alaska	0	0
Arizona	123.8	117.2
Arkansas	227.8	257.9
California	443.4	471.8
Colorado	49.3	58.7
Connecticut	1.0	1.4
Delaware	2.7	3.3
Florida	186.2	173.5
Georgia	674.7	637.2
Guam	.07	.07
Hawaii	.5	.9
Idaho	122.0	151.8
Illinois	71.1	87.6
Indiana	119.9	158.6
Iowa	86.3	136.8
Kansas	52.4	84.2
Kentucky	24.0	36.1
Louisiana	310.0	320.7
Maine	31.5	27.5
Maryland	9.2	11.4
Massachusetts	1.4	2.4
Michigan	86.5	106.9
Minnesota	163.6	223.9
Mississippi	532.5	556.1
Missouri	130.9	163.7
Montana	73.1	97.0
Nebraska	108.8	173.5
Nevada	6.1	8.7
New Hampshire	.04	.04

State/territory	Over-3-year delinquent dollars[a] (millions)	Outstanding principal owed by over-3-year delinquent borrowers[a] (millions)
New Jersey	$ 13.3	$ 14.3
New Mexico	29.3	34.8
New York	93.6	108.9
North Carolina	133.8	150.6
North Dakota	110.8	158.7
Ohio	65.9	89.5
Oklahoma	169.6	215.9
Oregon	49.7	67.1
Pennsylvania	24.3	33.8
Puerto Rico	16.0	23.1
Rhode Island	.4	.5
South Carolina	110.0	126.8
South Dakota	107.2	158.4
Tennessee	104.7	131.1
Texas	482.9	437.4
Utah	6.4	9.1
Vermont	1.4	2.3
Virgin Islands	.5	.9
Virginia	66.4	69.2
Washington	46.0	62.8
West Virginia	5.9	7.9
Wisconsin	79.7	118.1
Wyoming	20.3	28.3
Total	$5,464.4	$6,209.4

[a]The total for delinquent dollars and outstanding principal may not add because of rounding of the individual state amounts. In addition, over-3-year delinquent dollar amounts can exceed outstanding principal owed by over-3-year delinquent borrowers because delinquent dollar amounts include both principal and interest.

Source: GAO analysis of FmHA Active Borrowers Delinquent Report data (FmHA report code 616).

Senator BOREN. Thank you very much, Senator Conrad.

Now I will turn to our colleague from South Dakota. I appreciate your southern hospitality to your neighbors in the north. We made him an honorary subcommittee member and let him go ahead and speak.

Senator Daschle.

STATEMENT OF HON. THOMAS A. DASCHLE, A U.S. SENATOR FROM SOUTH DAKOTA

Senator DASCHLE. Thank you, Mr. Chairman. I will defer to the Senator from North Dakota at any time.

I also will not reiterate the charges because I do believe Mr. Clark deserves a hearing with regard to these comments. I would sincerely hope that we are not going to see a politicized Farmers Home Administration and judging from those quotes—and I hope they are inaccurate—that is nothing but politicized high charged rhetoric to juice up those opponents of the Farmers Home programs that we have fought so consistently for. So it is extraordinarily disconcerting to see this kind of rhetoric. And as I say, I am anxious to hear the explanation and hopefully a retraction, if these comments in any way are accurate.

Like Senator Conrad, I am extraordinarily concerned, as well, about the slow-moving process by which we have implemented this bill. There is an old slogan that we have all heard that nothing is slower than watching grass grow.

Well, I think we have finally found something that would compete with watching grass grow. We have seen a crop planted and a crop harvested in the time that it has taken to implement these regulations, and that is outrageous. The only part of the new bill that apparently is being accelerated is, again—which Senator Conrad mentioned—the sale of land.

We have actually seen an accelerated sale of land in South Dakota. We have the third largest land seller in Farmers Home in the country with 116 parcels sold; substantially more—25 percent more—than we sold in 1987 in spite of the fact that we have seen a freeze this year. Supposedly in January there was a freeze with two very tight exceptions, and yet with that freeze we are selling more land in 1988 thus far than we sold in the entire year 1987.

So there is a lot of explaining to do here, both with regard to the inaction of the Farmers Home with regard to the implementation of the regulations, the accelerated sale, and the comments. So this ought to be a very productive hearing and I look forward to the comments of all of our witnesses.

Senator BOREN. Thank you very much, Senator Daschle.

Today we will be hearing from, of course, Mr. Clark, the Administrator of the Farmers Home Administration. We will be also hearing from Mr. Lee Swenson, the president of the National Farmers Union; Mr. Benny Bunting, president of the National Save the Family Farm Coalition; and Mr. James Massey, executive director of the Farmers' Legal Action Group, Inc.

As I said, we have statements that have been submitted from a number of other farm organizations as well that will be received for the record.

Mr. Clark, we would be happy to have you come forward and receive your testimony at this time. If you would like, you can begin with your opening statement. If you want to summarize your opening statement, we would be happy to receive it in full for the record.

STATEMENT OF VANCE L. CLARK, ADMINISTRATOR, FARMERS HOME ADMINISTRATION

Mr. CLARK. I am indeed still invited to the table?

Senator BOREN. I think so. In fact, we are anxious to hear from you maybe on some of the points that have already been raised.

Mr. CLARK. Thank you, Mr. Chairman, I do appreciate that.

I welcome this opportunity to be with you today to bring you up to date on the progress of the implementation of the Farmers Home Administration portion of the Agricultural Credit Act of 1987.

We are making good progress in that entire, very complicated process, Mr. Chairman, in a sincere attempt to meet the full intent of Congress as well as the letter of the law. Our progress has been more visible with some sections of the act than others, but we are moving ahead on all fronts of that implementation.

Through this whole process, however, we want to ensure that the public is fully informed of the statute's provisions and has ample opportunity to address our plans to implement them. For these reasons and at the request of some Members of Congress, we have—as you know, Mr. Chairman—issued the amended regulations, on September 14, as interim rather than final regulations.

We have offered an additional 60-day comment period on those regulations. This will permit continuing public participation in the development process and simultaneous preparation for the important loan restructuring program in the field. Training of our field office staff is well underway and will be completed in ample time for this year's loan reviews.

In the meantime, as I said, we have been going forward with a number of the act's provisions. For example, the statutory mandate for a new borrower appeals system has been implemented. The director and other managers have been selected and are on the job. Those regulations were published in final form on July 12, and all but a few of the 57 hearing officers have been hired and are in position.

In the interest of objectivity, we selected almost one-half of the hearing officers from outside the Farmers Home Administration. Some came from other Federal agencies, and some from outside the Government. All appear to have the experience and the ability we need.

This new group, which we identify as the National Appeals Staff, reports directly to me. It has no organizational or structural relationship to our loan program divisions. In fact, it is even domiciled separately. The headquarters unit is located across the river in Alexandria. The western zone supervisor—and there are three such supervisors—is in Denver; the eastern zone supervisor is in Indianapolis, and the southern zone supervisor, who joined us from an-

other agency, is in Memphis. The hearing officers are located in the States with the most active appeals history.

Training for the appeals personnel has been completed, and I am pleased to report that our appeals staff is in business.

Another important service provided our borrowers through the act, that we were able to adopt quickly, was mediation. I wrote to all the Governors shortly after the bill was signed, told them of the certification requirements and invited them to participate. Thirty-three Governors have indicated interest so far.

We have issued interim certifications to Alabama, Iowa, Kansas, Minnesota, Mississippi, Montana, Nebraska, North Dakota, Oklahoma, South Dakota, Texas, Wisconsin, and Wyoming. We expect certification of other States will be forthcoming.

Our people have already begun to participate in mediation cases and we are learning some important, and I think encouraging, lessons as we do that.

For one thing, communications between borrower and lender obviously improve noticeably during mediation. Personal hostility that may have developed over a long period tends to begin melting away when a neutral, third party enters the discussion. You can concentrate on problems such as the condition of the farming operation or management skills, good or bad, of the farmer. It can be hard to get to real problems such as these, when everybody gets hung up on bad personal relationships.

Another important point is that third-party creditors—especially unsecured or undersecured ones—get a better understanding of the positions of all the creditors. They realize that a little patience often can reward all of those in the credit boat—and not just fill the plate of one at the expense, and ill will, of the many.

One early mediation case had an interesting turn. After the meeting, it appeared that nothing could be done to help the FmHA farm borrower, who also has land bank credit, continue in business—except possibly a write-down as provided for in the Agricultural Credit Act. So, by common agreement, the case was put on hold until our regs were out. Another attempt will now be made to restructure. So it is an ongoing relief.

We have been able to move ahead on several other separate provisions of the Agricultural Credit Act while at the same time, working on the whole. They include:

INVENTORY PROPERTY DEMONSTRATION

Under this provision, FmHA can issue certificates worth 4 percentage points in interest to enable an FmHA-eligible family farmer to purchase farm property in the inventory of eligible Farm Credit System institutions. We have executed a memorandum of agreement with the Farm Credit Administration and are now waiting for them to identify the inventory being targeted for this program and to furnish to us their appraisal information.

HOMESTEAD PROTECTION

We have already notified all previous owners of farms in FmHA inventory of the right to apply for the homestead retention option under the more liberal terms of the Agricultural Credit Act. This

includes owners of all inventory farms whatever the date of acquisition. Sales from our inventory have been suspended in the interim.

COUNTY COMMITTEES

Final regulations expanding eligibility for voting and candidacy were published in March, in ample time for the elections which were held on June 30. This provision also extends the nominations and election notification periods. From all indications, these elections were conducted smoothly and with little controversy.

INCOME RELEASE

Borrowers whose accounts were accelerated between November 1, 1985 and May 7, 1987, but not liquidated, were notified of their right to apply for debt restructuring and the release of up to $18,000 from the sale of normal farm income security to pay essential farm operating and family living expenses. We have already released funds to those who requested them, and those borrowers are first in line for loan restructuring consideration.

OWNERSHIP FOR DISADVANTAGED PERSONS

Funds were set aside this year for farm ownership loans to socially disadvantaged persons eligible to purchase land in FmHA farm inventory or on the open market. We have already approved 19 loans totaling $1.5 million in 11 States and Puerto Rico. An outreach program is being developed so that all who apply for FmHA farm loans will be aware of this opportunity for farm ownership.

The secondary market is an entirely new operation for us, but we are working on it in separate regulations still underway, and we are aiming for publication the last week of October.

Of course, loan restructuring and related debt relief provisions of the act are of paramount interest to so many, both on the farm and here in Congress. I assure you, Mr. Chairman, that it has been a top priority of a good many FmHA employees over the last 6 months as well. We estimate, conservatively, that well over 20,000 hours of FmHA staff time has been consumed in our efforts to make the act operational. Many of those hours came before and after regular working hours as well as on weekends. So I think that is a credit to our staff. That total is roughly equivalent to 10 full-time staff years.

And, as expected, following publication of our proposed regulations, we received a heavy volume of public comment, 247 in all. Some were predictable in opposing any write-down of loans for farmers. A large number were general in nature or were seeking clarification of some specific point or position. Many were constructive in tone and content, and we appreciate their suggestions. We adopted a great many of those comments.

Among the responses offering constructive, specific suggestions was a truly helpful and a very lengthy document from an advocacy group in the Upper Midwest, the Farmers' Legal Action Group, or FLAG.

The FLAG people did an in-depth, highly detailed analysis of the entire Ag Credit Act and the proposed regulations. One particular-

ly good recommendation concerned a procedural aspect that we have had trouble with in the past; that is, the language and organization of the various notices that we send to borrowers to notify them of their servicing options when they fall behind on their payments.

FLAG hired a readability expert who found our proposals still short on clarity and general design. But instead of merely complaining, they redesigned and rewrote the notices in such an appealing form that we adopted them almost in their entirety.

Mr. Chairman, that is only one sample from what is probably the most helpful collection of comments on any proposed rules that Farmers Home has ever published. Let me give you a few more to illustrate the breadth of the interest and knowledge that has been shared with us. These are all suggestions that we adopted.

Preservation loan services of homestead retention and lease-back/buy-back options will be offered before acceleration and liquidation of loans for borrowers who respond to the notice of loan service availability, and whose loans cannot be restructured.

Primary services of loan rescheduling or reamortization will be made available before a borrower becomes delinquent. County office employees will schedule annual loan reviews far enough in advance of the loan due date, to spot potential problems and offer the borrower the servicing options.

Similarly, borrowers who are able to pay a partial but not a whole payment on their loan or loans will be provided primary loan services—another way to assist the borrowers before the account becomes delinquent.

A financial plan required for a loan will not have to show a reserve allowance or profitability to be considered feasible. A break-even plan will be acceptable to us.

A borrower will be offered primary and preservation services at the same time, instead of in separate sessions. If ineligible for both, appeals rights for both will be given to the borrower at that time.

Mr. Chairman, this is by no means intended to be a comprehensive list of the provisions covered in Senator Harkin's observations of 160 pages of our interim final regulations published in the September 14 Federal Register for the Ag Credit Act. It is, however, a sampling of the public response to the proposed regulations and our reaction to that response. I think it demonstrates, quite clearly, our efforts to carry out this program as you in Congress intended and it will be done to the best of our ability.

This concludes my formal statement, Mr. Chairman. If you have any questions, I will be glad to attempt to answer them.

[The prepared statement of Mr. Clark follows:]

STATEMENT OF
VANCE L. CLARK, ADMINISTRATOR
FARMERS HOME ADMINISTRATION
UNITED STATES DEPARTMENT OF AGRICULTURE
Before the
SUBCOMMITTEE ON AGRICULTURAL CREDIT
SENATE COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY
September 30, 1988

Thank you, Mr. Chairman and Members of the Committee. Good morning. I appreciate the invitation to be with you today to bring you up to date on our progress in implementing the Farmers Home Administration portion of the Agricultural Credit Act of 1987.

We are making good progress in that entire, very complicated, process, Mr. Chairman, in a sincere attempt to meet the full intent of the Congress as well as the letter of the law. Our progress is more visible with some sections of the Act than others, but we are moving ahead on all fronts.

Through this whole process, however, we want to ensure that the public is fully informed of the statute's provisions and has ample opportunity to address our plans to implement them. For these reasons, and at the request of some members of Congress, we have — as you know -- Mr. Chairman — issued the amended regulations, on Sept. 14, as interim rather than final regulations.

We have offered an additional 60-day comment period on those regulations. This will permit continuing public participation in the development process and simultaneous preparation for the important loan restructuring program. Training of our field office staff is well underway and will be completed in ample time for this year's loan reviews.

In the meantime, as I said, we have been going forward with a number of the Act's provisions. For example, the statutory mandate for a new borrower appeals system has been implemented. The director and other managers have been selected and are on the job. Those regulations were published in final form on July 12, and all but a few of the 57 hearing officers have been hired and are in position.

In the interest of objectivity, we selected almost one half of the hearing officers from outside the Farmers Home Administration. Some came from other Federal agencies, and some from outside Government. All appear to have the experience and ability we need.

This new group, which we identify as the National Appeals Staff, reports directly to me. It has no organizational or structural relationship to our loan program divisions. In fact, it is even domiciled separately. The headquarters unit is located across the river in Alexandria. The western zone supervisor, and there are three such supervisors, is in Denver; the eastern zone supervisor in Indianapolis, and the southern zone supervisor (who joined us from another Agency) is in Memphis. The hearing officers are located in the States with the most active appeals history.

Training for the appeals personnel has been completed, and I am pleased to report to you that our appeals staff is in business.

Another important service provided our borrowers through the Act, that we were able to adopt quickly, was mediation. I wrote to all the Governors shortly after the bill was signed, told them of the certification requirements and invited them to participate. Thirty-three Governors have indicated interest so far.

We have issued interim certification to Alabama, Iowa, Kansas, Minnesota, Mississippi, Montana, Nebraska, North Dakota, Oklahoma, South Dakota, Texas, Wisconsin and Wyoming. We expect certification for other States will be forthcoming.

Our people have already begun to participate in mediation cases and we are learning some important -- and encouraging -- lessons as we do that.

For one thing, communications between borrower and lender obviously improve noticeably during mediation. Personal hostility that may have developed over a long period tends to begin melting away when a neutral, third party enters the discussion. You can concentrate on problems such as the condition of the farming operation or the management skills -- good or bad -- of the farmer. It can be hard to get to real problems such as these, when everybody gets hung up on bad personal relationships.

Another important point is that third-party creditors, especially unsecured or under-secured ones, get a better understanding of the positions of all the creditors. They realize that a little patience and effort often can reward all of those in the creditor boat -- and not just fill the plate of one at the expense, and ill will, of the many.

One early mediation case had an interesting turn. After the meeting, it appeared that nothing could be done to help the FmHA farm borrower (who also has land bank credit) continue in business -- EXCEPT possibly a write-down as provided for in the Ag Credit Act. So, by common agreement, the case was put on hold until our regs were out. Another attempt will now be made to restructure. So it is ongoing relief.

We have been able to move ahead on several other separate provisions of the Ag Credit Act while, at the same time, working on the whole. They include:

Inventory Property Demonstration. Under this provision, FmHA can issue certificates worth 4 percentage points in interest to enable an FmHA-eligible family farmer to purchase farm property in the inventory of eligible Farm Credit System institutions. We have executed a memorandum of agreement with the Farm Credit Administration and are ready to go with this as soon as they identify the inventory being targeted for this program and furnish to us their appraisal information.

Homestead Protection. We have already notified all previous owners of farms in FmHA inventory of their right to apply for the homestead retention option under the more liberal terms of the Ag Credit Act. This includes owners of all inventory farms whatever the date of acquisition. Sales from our inventory have been suspended in the interim.

County Committees. Final regulations expanding eligibility for voting and candidacy were published in March, in ample time for the elections which were held on June 30. This provision also extended the nomination and election notification periods. From all indications, those elections were conducted smoothly and with little controversy.

Income Release. Borrowers whose accounts were accelerated between Nov. 1, 1985, and May 7, 1987, but not liquidated, were notified of their right to apply for debt restructuring and the release of up to $18,000 from the sale of normal farm income security to pay essential farm operating and family living expenses. We have already released funds to those who requested them, and those borrowers are first in line for loan restructuring consideration.

Ownership for Disadvantaged Persons. Funds were set aside this year for farm ownership loans to socially disadvantaged persons eligible to purchase land in FmHA farm inventory or on the open market. We have already approved 19 loans totaling $1.5 million in 11 States and Puerto Rico. An outreach program is being developed so that all who apply for FmHA farm loans will be aware of this opportunity for farm ownership.

The secondary market is an entirely new operation for us, but we are working on it in separate regulations still under way, and we are aiming for publication the last week of October.

Of course, loan restructuring and related debt relief provisions of the Act are of paramount interest to so many, both on the farm and here in Congress. I assure you, it has been a top priority of a good many FmHA employees over the last six months as well. We estimate, conservatively, that well over 20,000 hours of FmHA staff time have been consumed in our efforts to make the Act operational. Many of those hours came before and after regular working hours as well as on weekends, a credit to our staff. That total is roughly equivalent to 10 full-time staff years.

And as expected, following publication of our proposed regulations, we received a heavy volume of public comment, 247 in all. Some were predictable in opposing any write-down of loans for farmers. A large number were general in nature or were seeking clarification of some specific point or position. Many were constructive in tone and content, and we appreciate their suggestions. We adopted a great many of them.

Among the responses offering constructive, specific suggestions was a truly helpful and very lengthy document from an advocacy group in the Upper Midwest, the Farmers' Legal Action Group, or FLAG.

The FLAG people did an in-depth, highly detailed analysis of the entire Ag Credit Act and the proposed regulations. One particularly good recommendation concerned a procedural aspect that we have had trouble with in the past; that is, the language and organization of the various notices that we send to borrowers to notify them of their servicing options when they fall behind on their payments.

FLAG hired a readability expert who found our proposals still short on clarity and general design. But instead of merely complaining, they redesigned and rewrote the notices in such an appealing form that we adopted them almost in their entirety.

Mr. Chairman, this is only one sample from what is probably the most helpful collection of comments on any proposed rules that Farmers Home has ever published. Let me give you a few more to illustrate the breadth of the interest and knowledge that has been shared with us. These are all suggestions that we adopted.

• Preservation loan services of homestead retention and lease-back/buy-back options will be offered BEFORE acceleration and liquidation of loans for borrowers who respond to the notice of loan service availability, and whose loans cannot be restructured.

• Primary services of loan rescheduling or reamortization will be made available BEFORE a borrower becomes delinquent. County office employees will schedule annual loan reviews far enough in advance of the loan due date, to spot potential problems and offer the borrower the servicing options.

• Similarly, borrowers who are able to pay a partial but not a whole payment on their loan(s) will be provided primary loan services — another way to assist the borrower before the account becomes delinquent.

• A financial plan required for a loan will not have to show a reserve allowance or profitability to be considered feasible. A break-even plan will be acceptable!

• A borrower will be offered primary and preservation services at the same time, instead of in separate sessions. If ineligible for both, appeals rights to both will be given to the borrower at that time.

Mr. Chairman, this is by no means intended to be a comprehensive list of the provisions covered in the 160 pages of our interim final regulations published in the Sept. 14 Federal Register for the Ag Credit Act. It is, however, a sampling of the public response to the proposed regulations and our reaction to that response. I think it demonstrates our efforts to carry out this program as you in Congress intended and to the best of our ability.

This concludes my formal statement. If you have any questions, I will be glad to attempt to answer them.

Senator BOREN. Let me say to members, we will rotate our questioning in 5 minute intervals and you will be handed a note when the time is nearly up and that way we can make sure that all members of the committee have the opportunity to ask the questions they would like to ask.

Let me begin first—and not to be quarrelsome—but I would like to raise the question that has been raised in I believe every opening statement because this committee did work so hard and in such a bipartisan fashion and so closely with many different agencies of the administration, not just your own, but the Department of the Treasury, and many, many others were involved in the course of putting together this legislation.

Did you mean to refer to this act when you talked about socialism? Did you mean to refer to this committee? Did you mean to refer to me and to Senator Leahy and Senator Lugar and Senator Boschwitz and others who have led this legislation? Is that accurate or inaccurate?

Mr. CLARK. If it is quoted it is inaccurate. I did not refer to the Agricultural Credit Act as resulting from the liberal decisions that this group or any Member of Congress made. The Agricultural Credit Act was not part of that observation.

Senator BOREN. So you weren't referring to the Agricultural Credit Act as a socialist piece of legislation?

Mr. CLARK. I was not.

Senator BOREN. Let me go into the regulations here. You mentioned the mediation programs and I was glad to hear your positive comments about them because I think they do very often result in bringing people together with an outside person that brings a new perspective. We do have some States, however, as you know, that have a voluntary mediation program so that other creditors can refuse to participate.

In reading the regulations—and I may be incorrect on this—it seemed that it could possibly permit the Farmers Home Administration to refuse to participate in specific mediations in States that have voluntary mediation programs.

Of course, I believe, and certainly I think the spirit of the law was very clear that in States that have voluntary mediation programs, the Farmers Home Administration would participate in those programs. Of course, we are not coercing individuals to participate, but if the individuals request mediation, the intent of the act was that Farmers Home would participate. I just wonder, do the regulations permit the Farmers Home Administration to decide not to participate in mediation if the borrower requests mediation?

Mr. CLARK. No, they do not. In fact, there is a typo. Would you believe that? I did not think that was possible. But the Federal Register made a typo when they published our regulations for mediation. They used the word "requested" and it should be "required." They are going to correct that very soon.

Senator BOREN. Thank you. That clears that up and I appreciate that answer, because I thought from your earlier statement that it must be that you were supporting full participation in the voluntary mediation program, so I appreciate that.

I believe proposed regulations were issued on June 17 on the joint Farm Credit System/Farmers Home Administration demon-

stration project which is designed to help family farmers purchase Farm Credit System acquired property. Three Farm Credit districts have been certified. Farmers in these districts are now eligible for the program and I wondered when the final regulations might be issued on this demonstration project?

Mr. CLARK. We hope in the next few weeks, Mr. Chairman. We are now having a little problem with the Treasury Department trying to determine whether the funds involved in some of that stuff affect us. I am sorry, I am confusing that with another one we have on the secondary markets.

The Farm Credit System, that is yet a few weeks away but we are yet waiting—and I make that point again—we have not heard from any of those three districts as to what property they wish to put into the program and their appraisal information. We need that before we can go forward. But when they are ready, we should be ready.

Senator BOREN. To issue the final regulations on those projects?

Mr. CLARK. Yes.

Senator BOREN. Now, I want to go, before I turn to my colleagues, to a point that has been raised by several people here today, and that is what appears to be a disturbing increase in the amount of land sales, that even though a freeze was put in place in January, we seem to have a 25 percent increase in sales. I just looked at the figures for 10 States in which we have had 1,913 parcels sold with a total value of $153 million. And then there seems to be a disturbing increase in the amount of these that were described as surplus rather than as suitable.

Of course, the act established a tighter definition so that we would not have as many properties declared as surplus. The new definition created a presumption of suitability unless the property cannot be used for any farm ownership loan purpose or if the farm ownership land uses include being used as a start-up or add-on parcels. The new suitability definition extended to property currently classified as surplus and required reclassification of such property. It also said that the County Committees are to determine suitability and not the County Supervisors.

So I wondered what happened here. The January freeze did not apply to sales to former owners and contracts approved prior to January 14, 1988. Do all the land sales amounting to $150 million in value fall into these two categories and why are the ratios of the surplus so high in some States since the 1987 amendments were meant to tighten up the definition of what surplus is and to put more—in essence, we were aiming at putting more parcels of land, a greater proportion, into the suitability category?

Why has this happened?

Mr. CLARK. Well, first of all, Mr. Chairman, we did stop the sale of any of our inventoried land upon the effective date of the legislation when the President signed it in January. However, prior to that time there were many legal contracts going and committed us to sell some of that land, so they had to be finalized after the January date. And we are still able to sell that land back to the previous owners, and so I think a great deal of that land was put back into the hands of the original borrowers.

So I think there is considerable activity in those two directions and that is about the extent of our land sales during that period. We are holding fast now and not selling that property. Classification, true, will now take a new twist to it. The County Committees have to do it and we are starting October 14, the effective date of the Agricultural Credit Act regulations, to reclassify that land. So now that burden is on the County Committees and they will do that.

We expect a lot of that land to, indeed, be put back into the production end rather than surplus.

Senator BOREN. And to the suitability category.

Thank you very much. Senator Harkin.

Senator HARKIN. Thank you very much, Mr. Chairman.

Mr. Clark, if you weren't referring to the Farm Credit Act or this subcommittee with charges of socialism, if you weren't referring to the Agricultural Credit Act as socialism or that we were pushing FmHA toward socialism, then what were you referring to? I have here a release from UPI that says: "The U.S. Farmers Home Administration will lose $2 billion this year, a financial deficit its Administrator says is indicative of policies forced by liberal legislators pushing the agency toward 'socialism.' "

Well, if you weren't referring to the act, what were you referring to?

Mr. CLARK. Well, Senator, I smarted a little over some of the things that happened on the other side of the Hill. The House side particularly has taken some actions that I think are incorrect. Mr. Whitten in the appropriations, as you know, in the continuing resolution required us to continue with a borrower who is delinquent and unable to pay his debts to us, that we had to extend 1 more year operating credit to that borrower if the other creditors would stand by for that one year. I think that is wrong. I think it is a pretty good example of micro managing the credit functions of this important agency.

Another good example is, as we collect our debts, we are the only agency that I am aware of that cannot use collection agencies. The only one. HUD, Education, all of them can but not Farmers Home; again, because it is stuck into some resolution on the House side that precludes us from doing that.

I think that is wrong. Those are a couple of good examples, I think, of things I was referring to.

Senator HARKIN. The first one was from Chairman Whitten on the House side who you said required Farmers Home to stick with a farmer for 1 year even though the farmer was—what did you say? Delinquent?

Mr. CLARK. Could not pay his debts and could not cash-flow his operation. We were required to, again, grant additional credit for operating loans. And that has the full effect of law coming out of a resolution, no hearings, no nothing. I think that is wrong.

Senator HARKIN. Would this be involved in mediation at all?

Mr. CLARK. Not at all.

Senator HARKIN. So those are basically the two things that you were referring to, that you could not use collection agencies and the requirement that Farmers Home stick with a farmer or provide

loans to a farmer? That is what you are saying? Not stick with him but to provide——

Mr. CLARK. Additional money.

Senator HARKIN. Even though they could not cash-flow and they were delinquent?

Mr. CLARK. Right.

Senator HARKIN. Let me look into that some more.

Let me quote one other quote from this press release. I want to ask you about——

Mr. CLARK. Incidentally, that is not my press release.

Senator HARKIN. I know, and you say that you did not say this, and that is fine.

Mr. CLARK. We don't issue press releases about those losses. We did not do that.

Senator HARKIN. I said it was UPI.

Mr. CLARK. Yes.

Senator HARKIN. UPI is quoting you and here is the quotation they attributed to you: "I've been told, 'Don't work too hard at collecting these loans,' " Clark said, referring to legislators who view such collection efforts as detrimental to a positive image in their home districts. "It is so easy to cave in to special interests . . . It's a very sad state of affairs," again, to quote you.

Again, I don't understand what that means. "Don't work too hard at collecting those loans."

Do you feel that we are telling you that somehow these loans should not be collected or something? I don't understand what you are talking about.

Mr. CLARK. I am back, Senator, to the collection agency aspect where we assigned accounts to a collection agency. Those were totally, in our mind, uncollectible. We were asking the collection agency to verify once more and then we were going to write them off. But I was precluded from doing that and told to stop it, and they took funding away from me that we could use no operating funds in the Farmers Home for any collection effort with collection agencies. That is what I am referring to.

Senator HARKIN. OK. That cleared that up. Others may have other questions about it. I will think about that a little bit longer.

Let me get into some more substantive areas here.

About the mediators, now you are required to participate in mediation. You talked about it in your opening statement.

We are somewhat concerned, as the regulations state, when a mediator is not available, the State Director will designate a Farmers Home representative, not previously involved in the borrowers account, to conduct the meeting of creditors. Now, we know from experience that for mediation to be successful that both parties, and certainly the farmer, has to view the mediator as neutral. If Farmers Home designates an internal Farmers Home person, even though they haven't been connected with that individual debt, to conduct the meeting, will the farmer really view that person as neutral? And will the farmer feel that it is a neutral kind of a process?

What I am asking is when you say that a mediator is not available the State director will designate a Farmers Home representative, and does that not take it away from that neutral process in

the farmers mind? You have a Farmers Home pers... sitting there conducting the meeting.

Mr. CLARK. No. I think that is somebody who is a decisionmaker in our agency who will sit down with other creditors. If there is no mediation available, then it is, in our opinion, to the benefit of the borrower that we sit down with all the creditors and talk about that problem. I think it is really not mediation in that direction. It is really to sit down with all the creditors and try to talk that out and try to get them to cooperate with us.

If anything, I think it is an outreach program on our part to help resolve those problems when mediation is not available. We will mediate any time we can and use the facilities of mediation any time we can. But if they are not there, the least we can do is get the other creditors and sit down around the table.

Senator HARKIN. What kind of training will these people have in mediation? You know, we have found, again, in those States where they have had successful mediation, a small amount of training on how to conduct this process is just vital.

Mr. CLARK. Well, again, I think you are confusing mediation with a meeting of creditors, and you are going in the right direction. However, other borrowers don't have to mediate. You know, there is no law that says you have to come to the table in mediation.

I think this is really an effort on our part to at least get them to sit down and talk about it and maybe mediation won't scare them away, either.

It is a meeting of the creditors to talk about that problem and see if we can keep that borrower going.

Senator HARKIN. I have no further questions at this time.

Senator BOREN. Thank you very much. Senator Daschle.

Senator DASCHLE. Mr. Clark, let me take another shot, briefly, at a clarification of that rhetoric UPI has reported. You have indicated to us that you differ with Chairman Whitten on what forbearance ought to be provided to many of these delinquent borrowers and whether we ought to use collection agencies, and on the basis of those two examples, you say your agency is being pushed toward socialism.

Do you really believe that? Or do you think that might be too strong a statement?

Mr. CLARK. Well, Senator, I have served in two different wars, World War I and the Korean War. I was fighting for democracy and I guess I get a little perturbed when somebody starts making motions that says, you know, democracy is going to change, and socialism bothers me.

We still have free speech, that right, in this country. I guess when I get off my Washington tether, and get out in the other States, I speak up about it.

Senator DASCHLE. But you are speaking as the Administrator of the Farmers Home Administration, a credible position. You are the Administrator and what you are saying is that you think your agency is headed toward socialism.

I mean, that kind of rhetoric has no place in a credible agency administered by what we hope would be a reputable Administrator and what private citizen Vance Clark says and what Administrator Vance Clark says ought to be two different things.

In my view, that is just inexcusable. Let me ask you this, you say that the liberal Congressmen and Representatives who head key committees—you have indicated that you were referring there to Chairman Whitten—are beholden to special interest groups vital to re-election efforts.

Can you document that for us?

Mr. CLARK. Senator, I guess the appropriations that were just passed yesterday in which we are directed to fund specific cases in Mississippi and a few other States, may be is the best documentation that I could give you.

Senator DASCHLE. So that a chairman who has funded something in his State, you are saying, is the documentation you have which lays credibility to your claim that he is beholden to special interest groups?

Mr. CLARK. Well, you and I obviously have a different interpretation.

Senator DASCHLE. Well, I guess so.

Mr. CLARK. But this is certainly an indication that——

Senator DASCHLE. Well, the whole point here is that you were caught. I mean, I bet you that you probably did not realize the press was there and that you were going to get this kind of coverage and God only knows how many more times around the country Vance Clark has made this kind of rhetorical flourish with regard to your own views about the way this agency is being run.

But unless you can substantiate with a little more credibility that your agency is moving toward socialism, unless you have got more documentation than what you have been able to demonstrate to this subcommittee—and you have mentioned in the plural, liberal Congressmen and Representatives—I assume there is more than Jamie Whitten here—that is the only documentation you have offered in that regard—are beholden to special interest groups when they find something for their States, they are willing to put it in a bill.

I would really hope that you take another look at your speech writers and demand a little more credibility.

We don't need that kind of politicized environment. It is too politicized as it is. You have emotions running very high on all sides in this thing and this plays right into the hands of people who would like to see more of that kind of garbage. And I think there is no place for it.

Let me ask you a couple of questions here with regard to your testimony.

The Disaster Relief Act specifically stated that Farmers Home should use forbearance in the treatment of loans because of the drought. Understandably, Farmers Home has written a computer program that will take care of analyzing loan servicing options for borrowers. This program may be flexible enough to take into account adverse conditions, but I have received inquiries in my office as to how Farmers Home is treating borrowers during the time of the disaster in the drought and, specifically, is there a written policy as to how Farmers Home will exercise forbearance to borrowers who are unable to make their payments in whole or in part due to the drought? And have there been notices issued to State directors to encourage them with regard to dealing with cases such

as these? Will Farmers Home attempt to offset drought payments from ASCS?

Mr. CLARK. We have not done that. We have not made an attempt to offset those payments. Those payments are considered as income to our borrowers and are considered, as we work up a farm and home plan, a feasibility financial plan for that operation.

The disaster assistance bill—as you know, the regulations are not yet out. We are working on those and hope to have them out in a few weeks. We have notified our field of the pending disaster assistance bill and have encouraged them to do everything they can to help those drought victims, if they will, under our present emergency loan programs, that the other regulations are on the pad and we will have it out in a few weeks, but in the meantime, do everything that you can to help those drought farmers.

Senator DASCHLE. In the act it states in title 5, the Secretary, "Shall prescribe rules requiring each such program to participate in good faith in any state agricultural loan mediation program."

The law doesn't say only mandatory programs. What are your plans to conform with the intent of Congress should you consider allowing for restructuring in cases where borrowers request mediation in voluntary States?

Mr. CLARK. We will do it. If they request mediation and mediation is available, we will sit down and mediate. No doubt about it. We will not refuse to mediate. We are convinced it is a good tool. It gets the other creditors to the table, and that hasn't been done in so many cases.

Senator DASCHLE. How many loans, in your opinion, will be restructured under the interim regulations? And does this figure differ from the number used in the proposed regulations?

Mr. CLARK. That is hard to tell. You know, we really will not know until those borrowers appear at our offices and start working their individual problems through our process. It is hard to tell. We think a great many of them, thousands of them. I think we had an 18,000 figure out there originally; 37,000 might be eligible for service through that.

We have to recognize yet there are thousands of them who are not going to make it, you know. Not all are going to be success stories. You can't expect us to save every farmer out there. But we are going to try and that is the message we are getting out to our field. We will try.

Senator DASCHLE. Is my information correct that no loans have yet been restructured under the new regs? And if so, why?

Mr. CLARK. Well, the regs were just published September 14. They don't become effective—the effective date is October 14. That is why. On October 14 if a borrower comes to our counter and says, I want this restructured, and applies for it, we will give the documents to him and we will start it. Its effective date is what is holding that back.

Senator DASCHLE. Thank you, Mr. Chairman.

Senator BOREN. Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman, and I thank the Senator from South Dakota for allowing me this time.

I am interested in what would be your response if you were in a Town Hall meeting in North Dakota and your constituents said to

you, look, you passed this law months and months ago and we still don't have any restructuring taking place; how can it take this long?

What would your response be?

Mr. CLARK. Senator, I am not sure you realize what you have wrought. I will tell you, it is a very complicated law. You cannot just write regulations overnight. It is an ongoing, complicated process. It just takes time to wade through not only the letter of the law, but we have to look back behind it, too; what is the intent of Congress?

There are so many legal issues that come up that our General Counsel needs to get involved in. It just takes that long. You know, I defy anybody—anybody—to put those rules and regulations out at a faster pace. It is just impossible.

Senator CONRAD. Well, how would you answer those that say, look, the Farm Credit System responded much more rapidly than FmHA?

Mr. CLARK. Unfair comparison. The Farm Credit System was not nearly so burdened with the law as we were. You know, they did not have all the things that you asked us to do. It is not a Farm Credit System charge.

Senator CONRAD. All right. Let me just say that I have heard that criticism and I am sure other members have heard it and there is a feeling that there was a dragging of feet at FmHA, there was an unwillingness because of the opposition that we have heard so frequently along the way, which I think is a fair statement. I remember that the day we voted on the FmHA provisions we received, hand-delivered to us, a letter from the Secretary of Agriculture saying that he would recommend a Presidential veto if those provisions were included.

I think it is fair to say there was the sense that every step of the way we had the active opposition of yourself to making these changes. Let me just ask you directly, have you felt a reluctance to move because of your own opposition to what was done?

Mr. CLARK. Absolutely not. I am a good soldier, you know. When I get marching orders, I obey them. I defy you to find any evidence of resistance anywhere along the line, either in Washington or out in the field. That did just not happen.

Senator CONRAD. Good, and I appreciate that response and I hope it carries forward into the implementation because I think that is exactly what a person's reaction ought to be.

We do not always get our way around here and when we do not, we ought to implement what the law is.

Is it your belief that at this point the regulations fairly implement the intent of Congress?

Mr. CLARK. Yes. I must say, we worked awfully hard and I think we listened to what the other world was telling us. As I say, a majority of the comments that we received, the ideas were plugged into the rules and regulations and I think, yes, it does very well set out and put into motion the law and the intent of Congress.

Senator CONRAD. Let me pursue that with regard to a couple of specifics.

The regulations that have been drafted do not provide, for example, for restructuring for loans that would go to Indian land asso-

ciations and while those are not explicitly included in the law, there is really no logical reason to exclude them and I think clearly it would be in line with the intent of Congress that those Indian land associations be considered.

Would it be possible for you to take another look at that part of the regulations?

Mr. CLARK. We have looked several times, Senator. In fact, the General Counsel has made that determination, not us. We have asked General Counsel to guide us along that line, but they have said, no, we do not have authority, and so we had to omit it from the regs.

Senator CONRAD. What would it take for you to be persuaded, or in your judgment, what would it take for the General Counsel to be persuaded that that did come within the intent of Congress?

Mr. CLARK. I can't speak for the General Counsel. I do not know.

Senator CONRAD. Could you find out for us and give us some idea of what it would take?

Mr. CLARK. I would be happy to submit for the record the opinion of our General Counsel as it refers to the specific section of the law, yes.

[The material follows:]

D. Chator

August 30, 1988

TO: Glenn L. Bennett
Assistant Administrator
Community & Business Programs
Farmers Home Administration

FROM: Stephen L. Babcock STEPHEN L. BABCOCK
Assistant General Counsel
Community Development Division

SUBJECT: Authority to compromise or adjust Indian Land Acquisition Act Loans

Loans made under the Indian Land Acquisition Act, U.S.C. §§ 488-92, are administered under Subtitle D of the Consolidated Farm and Rural Development Act, 7 U.S.C. § 1921 et seq., with exceptions not relevant here. Subsection 331(d) of the Consolidated Farm and Rural Development Act, 7 U.S.C. § 1981(d), which is found within Subtitle D, gives the Secretary very broad authority to:

> "compromise, adjust, reduce, or charge-off debts or claims, and adjust, modify, subordinate, or release the terms of security instruments, leases, contracts, and agreements entered into or administered by the Farmers Home Administration under any of its programs, as circumstances may require, to carry out this title. The Secretary may not require liquidation of property securing any farmer program loan or acceleration of any payment required under any farmer program loan as a prerequisite to initiating an action authorized under this subsection. The Secretary may release borrowers or others obligated on a debt incurred under this title from personal liability with or without payment of any consideration at the time of the compromise, adjustment, reduction, or charge-off of any claim, except that no compromise, adjustment, reduction, or charge-off of any claim may be made or carried out--

> (1) on terms more favorable than those recommended by the appropriate county committee utilized pursuant to section 332; or
>
> (2) after the claim has been referred to the Attorney General, unless the Attorney General approves;"

This authority is very broad. The Secretary's authority is conditioned only upon his finding that the proposed settlement is "to carry out this title" (i.e., the Consolidated Farm and Rural Development Act), and that the settlement not be on terms more favorable than those recommended by the county committee. The reference to the duty "to carry out this title" is entirely vague, but can fairly be interpreted to mean that a settlement must not unnecessarily dissipate the agency's funds. This interpretation would be consistent with the basic purpose for the statutory settlement authority, which is to give the Secretary the maximum net recovery possible, taking into account the administrative expense involved in collection efforts, when the debtor cannot pay the debt in full.

Part 1864 of FmHA's regulations implement the statutory settlement authority quoted above insofar as Indian Land Acquisition Act loans are concerned. I will not attempt to recite all the sections of this Part, but will merely comment that those regulations contemplate that settlements of debts should be made at the maximum amount that debtors can reasonably be expected to pay (7 C.F.R. § 1864.2(d)), and that the debtor should be allowed to retain security property upon debt settlement only if the settlement compensates FmHA for the value of the property and if the debtor, in addition, has agreed to pay "any additional amount he is able to pay. . . ." (7 C.F.R. § 1864.3(a)(2)).

Finally, the question has arisen of whether the decision B-214 of the Comptroller General, 19 Comp. Gen. 49 (1939), has any bearing on this case. I do not think it has. Although the decision somewhat inartfully makes sweeping statements about not "giving away or remitting claims or debts due the government," it actually stands for the much narrower proposition that contracts cannot be renegotiated because of mutual material mistake of fact. It does not pretend to interpret the Secretary's settlement authority set out in 7 U.S.C. § 1981(d).

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Senator CONRAD. Well, I am really asking a further question than that. Would you inquire as to what kind of indication it would take to persuade the General Counsel that that did fall within the intent of Congress?

Mr. CLARK. I am not sure I can answer that, Senator.

Senator CONRAD. Well, it is a very simple question, Mr. Clark. I am simply asking, would you be willing to inquire of your General Counsel what it would take for him to be persuaded that that was included in the intent of Congress. It is not a difficult question to answer.

Mr. CLARK. I will be happy to do that. Would you be willing to change the law if that is what it takes?

Senator CONRAD. I certainly would.

Let me ask you about the training of hearing officers.

What kind of training are they being given?

Mr. CLARK. Very thorough training. I think we have had 2 weeks, two separate periods, of training for our hearing officers, and most of that training comes from the outside. We are using advice and counsel from outside Government to help us train those people, and I think they have done very well.

Senator CONRAD. What are the types of people that you have looked to to hire for those positions? That was obviously something of great concern to the Congress, that we have hearing officers that would do a good job. As you remember, there was one proposal on the table that they be administrative law judges. That was resisted with some, I think, good reasons. I did not necessarily agree with it, but there was a rationale, certainly.

What have you looked to in terms of qualifications for people?

Mr. CLARK. Well, I must say a great many of them have legal backgrounds and I think that is a good plus. That was part of the idea of half from inside the agency, half from out, to bring them together. That would give us a good mix of experience in programs with the experience from the outside, through whether it is mediation or the legal backgrounds or whatever.

Some of them are labor consultants, all kinds of backgrounds that have now married together, I think, and given us a good balance, if you will, of our hearing officers.

I would be happy to give you maybe a breakdown of those backgrounds, but I do not have that right in my hands.

Senator CONRAD. I would appreciate that.

[The information of Mr. Clark follows:]

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BACKGROUND OF FmHA FIELD HEARING OFFICERS

Current FmHA Employees	24
Non-FmHA Employees	26

Education

Post Doctorate:	1 - Doctorate of Jurisprudence
Post Masters:	1 - Economics
Masters:	4 - Business
	3 - Agriculture
	1 - Education
	1 - Political Science
	1 - Public Administration
First Professional Degree:	8 - Attorneys
Post Bachelor's Degree:	2 - Agriculture
Bachelor's Degree:	12 - Agriculture
	2 - Business Administration
	1 - Radio/Television
	1 - Social Science
No Degree:	12

Experience

FmHA Loan Making	25*
Banking/Loan Specialist	10
Attorneys	7
Crop Insurance Specialist	3
Auditor/Accountant	2
Court Clerk	1
Financial Consultant	1
Real Estate	1

*includes 1 reemployed annuitant

Senator CONRAD. All right, my time has expired.

Senator BOREN. Thank you very much, Senator Conrad.

Let me just ask—I just have a couple of more questions. Let me say, Mr. Clark, that I am going to declare off-limits any further comments or questions on the matter of the UPI remarks. I think we have all commented on those, and our purpose in bringing that up was not to barbecue you with them or to be unpleasant about it, but because of concern. I am sure some of us—all of us under the circumstances, probably—at one time or another in a political atmosphere have said things that carried a little further than we might have if we had thought exactly about the full meaning of them.

There are some things that could be complained about and sometimes the agency is being pushed and you have to resist and you deem them inappropriate, and I might even deem they were inappropriate, too.

Socialism was probably an overblown phrase. It kind of reminds me of a member of the State legislature who was defending small schools and the merit of small schools. He got a little carried away at the end and he said, ". . . and Abraham Lincoln went to a small school." And, he said, "He was one of finest men I have ever known". So these things do happen. We understand that.

I have to say that I know there is complexity in the regulations. I know they have taken a great deal of time. I think that you have had to take some time. They couldn't be written extraordinarily quickly if we are going to do a thorough job. And, we wanted a thorough job.

You have taken some very constructive suggestions and incorporated many of these suggestions in the regulations. And let me say that the main reason I brought up the comment was not to be unkind but really overall I think we have moved forward very well on the regulations in terms of content of these regulations. I think the agency is to be commended for the basic content of these regulations' main thrust and a lot of improvement has been made since the initial stages. I appreciate the fact that a lot of overtime hours have been put in.

I think what we are most sensitive about in this committee now is—to sum up my own personal feelings—this looks pretty good on paper to me. It looks pretty good. The important thing now is to make sure we really do it and that we really project that. As Senator Conrad said, this act was a product of compromise as we know, all the way through. My goodness, it is not the act I would have written or the act that the other two members that are here would have written. It is fraught all the way through with compromises. Although I would say when all was said and done, it was a pretty reasonable balance, reasonable enough for all of us, including the President and everyone else to say we are going to live with it.

So I would just hope that you might even project some enthusiasm about it. In other words, I understand what you are saying about being a good soldier, but I wish you would even go further than that and say, I am now going to be the enthusiastic commander of this exercise to see that it is carried out and that all of our folks up and down the line have a sense that this is really some-

thing that we are proud of. We are proud of the regulation. We think we have done a good job of the regulations.

You gave an example of the readability of the notices and these kinds of things. We ought to be proud of them when a bureaucracy makes every effort to speak in clear language that people can understand and identify. There are a lot of things here to be proud of that have been done and I think overall the act is something to be proud of and I think the regulations overall are something to really move us in the right direction.

That is all I would say. I would hope that in spite of a little bit of an interchange here today, or an exchange here today, that was not totally pleasant, I am sure for you, and not really pleasant for members of the committee either as we are sensitive because we are sincerely proud of what we tried to fashion and we are sincerely proud of the fact we tried to do it in a bipartisan way.

I do not know what went on elsewhere in the legislative process, but we know what we have done here and so broad overreaching statements about Congress get to us.

But I think we have something here we ought to all be enthusiastic about, that we have basically a good law—not perfect—and we have now some basically good regulations—not perfect—but basically good. And as you measure them against other agencies and other acts and other regulations, I would say we are far above average. I think we are headed to something we can be proud of and really go out and use.

Whether this will work or not really depends upon the spirit out there of the people in the field. If they really feel from headquarters that we want to get this out and really hustle and make this work, we are going to really give this a strong effort to make it work, and if we do, I am convinced we can help a lot of farmers, stabilize a lot of land values and hopefully in the long run reduce the ultimate amount of Government liability here. It is really a business-like approach tempered with some humility and the Government has to go beyond just a business-like approach sometimes and we have tried to strike that proper balance.

There were some things that I could not accept as a Senator. They went too far I think in making it unbusiness-like; and you have to also remember the other borrowers have paid their bills on time. You have to consider their feelings as well, too, so it was a balancing.

So that's all the comment I would make on that and I hope you will take that in the spirit with which it was meant. We are not going to rehash that matter any more. That is behind us and we do appreciate the hours of work that have been put in and we do appreciate the scores of constructive responses here to suggest changes in the regulations.

Let me ask one thing that does concern me a little bit, and maybe it is a lack of understanding on my part. I understand the Farmers Home Administration is using a transfer and assumption procedure which allows the Farmers Home Administration to bypass the inventory procedures and the family farm targeting. This may not be all bad.

What I am thinking about here is when you have a borrower in trouble, the land does not actually get into the inventory and a pri-

vate borrower is arranged. In other words, the land never really comes into the inventory. The transfer from the owner, the borrower, does not actually go into Farmers Home, but a buyer is arranged. In essence, the Farmers Home comes in and helps find a private borrower and this is done in a way then that there are new loan conditions set and it is satisfied.

I wonder if you could explain to us how this works and is my understanding of it correct? I am not saying I would be opposed to that being done. In many ways that might be the best, most business-like way of doing it. There are a couple of things that I worry about. It does bypass the normal inventory procedures in the classification of the land and some of the other procedures and my concern, I guess, is this: If the conditions of the loan are changed—in other words, the loan isn't in the legal title of the farm home, it is still the borrower—the Farmers Home helps arrange a private buyer, and I think oftentimes the terms of the loans are changed. In other words a certain amount of it is written off and so on so that the new borrower, a private purchaser from the original owner, takes it with new terms and new borrowing terms for the Farmers Home Administration.

Again, as I say, there is nothing inherently wrong with this and in some cases this might make good sense. It would concern me that it might open the door. Let's say that if you had somebody at the local level not operating appropriately, he might be able to go in and find a buddy, so to speak, and say, gee, I can really rewrite the terms of this loan in a really sweetheart deal if you would go and buy this direct from this farmer who hasn't transferred it to us yet but we are going to make him transfer it pretty soon if he doesn't find a private buyer.

I am a little worried about that and I wonder how the system works and if you have given some thought to how we can make sure where it is utilized that we are not just bypassing the inventory safeguards and that we are being sure to scrutinize that to protect against any possibility of these kinds of sweetheart deals being arranged.

Mr. CLARK. Well, we hope we are doing it, Mr. Chairman. Again, there is only certain authority delegated at that level to our County Supervisor and if he is forgiving debt or rewriting some of those situations, he does have to get authority from a higher source, either the district director or the State director or the program chiefs in the State office.

I think we have safeguards in there and we are watching for that. We are always watching for anything that is off-sheet somewhere and we have our own investigative systems that we plug in, our own assessment teams that go in there and review this, not only by the district but by the State as well.

I think we have our guard up on that happening. Not that we do not have those transfers, but usually that is instigated by the borrower, not Farmers Home. We do not go out and seek borrowers, farmers to buy that land. If something does happen, it usually emanates on behalf of our borrower who comes in and says, I want to sell it to my neighbor, Joe, and we will work together.

Senator BOREN. Yes, although your local office will have to jump in because the neighbor Joe is going to say, "Well, what terms

would I be able to survive on to buy it from you and what kind of security would Farmers Home give out in terms of their lien on the property?"

Do you have any idea? Feel free if any of your staff is with you, if you want to turn to them.

Do you have any idea of the volume of that that goes on?

Mr. CLARK. I do not, but we can do a little research and we would be happy to submit it for the record.

Senator BOREN. Yes, I would appreciate that.

Mr. CLARK. For the last fiscal year, what happened on those types of things?

Senator BOREN. I would appreciate that and you might give a little more thought and look into it, maybe make an evaluation for us of how you feel the safeguard aspect of it is working and to make sure it is adequate. I am sure that is something you and I would agree on, that we want to make sure that we do prevent that, and I realize, also, you cannot always just do that by writing more down on paper.

A lot of that has to do with just administrative efficiency of really being alert to watching for that. In fact, we have a law against bank robbery. It doesn't mean we do not have any banks getting robbed. So it is a matter of just effective enforcement. But I have had that concern expressed to me.

[The information of Mr. Clark follows:]

FmHA borrowers are generally aware that their mortgage requires consent by FmHA to any proposed sale or transfer of real estate security. See Attachment A as to the number of Transfers and Assumptions made during the 1988 Fiscal Year by State. FmHA does not keep data relating to the dollar amounts of the assumption or the interest rates to Transferees.

In addition to sale of land, transfer and assumption cases also include situations relating to deceased borrower's spouse, or where other relatives wish to continue the farming operation, or where one person withdraws from the operation as it relates to divorce decree or where the family changes from sole proprietorship to a Corporation or other entity.

For eligible transferees, FmHA interest rates can either be the same as charged to the borrower or that which is published for the type of loan involved. Terms or repayment period will not exceed the repayment period for a new loan involved. For example FmHA's Farm Ownership is 40 years.

For ineligible transferees, the balance of FmHA debt is scheduled for a repayment over a period not to exceed 15 years with amortized installments. The interest rate will be the published rate or the rate of the note assumed which ever is greater. State Director has authority to balloon installment for a longer repayment term not to exceed 25 years, if conditions in the area warrant it.

FmHA has several internal control mechanisms relating to Transfers and Assumptions. They include: (1) County, District and State Directors are authorized to approve transfers to eligible and ineligible transferees and to approve assumptions in acordance with their respective published Farm Program loan approval authorities. (2) All transfers must be based on present market value. (3) All transfers to eligible transferees, must meet the involved loan type eligibility requirements. (4) District Office Staff members are required to make a yearly review of one-fourth of the County Offices in their jurisdiction. The review includes Transfer and Assumption cases and (5) State Office Staff Members are required to review at least the County Office in each FmHA District each year. The review includes analysis of Transfer and Assumption cases pending and closed.

FmHA believes that these control mechanisms are adequate to assure that published FmHA Regulations are being followed.

U.S. DEPARTMENT OF AGRICULTURE—FARMERS HOME ADMINISTRATION

Listing of Transfers and Assumptions From October 1, 1987 to August 31, 1988, by State

State	*Transfer and assumption*
Alabama	5
Alaska	0
Arizona	0
Arkansas	21
California	5
Colorado	0
Connecticut	0
Delaware	0
Florida	1
Georgia	2
Hawaii	0
Idaho	9
Illinois	3
Indiana	2
Iowa	6
Kansas	2
Kentucky	9
Louisiana	2
Maine	0
Maryland	0
Massachusetts	0
Michigan	2
Minnesota	14
Mississippi	4
Missouri	4
Montana	5
Nebraska	6
Nevada	0
New Hampshire	0
New Jersey	0
New Mexico	3
New York	11
North Carolina	3
North Dakota	9
Ohio	0
Oklahoma	6
Oregon	3
West Pacific Territory	0
Pennsylvania	4
Puerto Rico	22
Rhode Island	0
South Carolina	0
South Dakota	15
Tennessee	10
Texas	17
Utah	1
Vermont	4
Virgin Islands	0
Virginia	1
Washington	6
West Virginia	2
Wisconsin	11
Wyoming	1
U.S. total	231

Source: Farm and Housing Activity Report, month ending 8/31/88.

Note.—Dollar amounts for transfers and assumptions not available on Farm and Housing Activity Report.

Prepared by: Farmer Programs—Program Development Staff, October 11, 1988.

Senator BOREN. With respect to the regulations on the debt restructuring calculations, I understand that they are to be run through a computer program. I would just urge that you make this material available—the kinds of ways in which the computer program is established—to farmers and farm organizations and extension offices and others that are working in this area. I think that if you have a sort of approach with computer programming principles that are being followed and it is not made available, there are always going to be a lot of people out there who suspect that the unknown is unfair. I have no reason to believe it isn't fair, but I would urge that you consider making it available.

I think we want to make sure that there is enough flexibility, obviously, in the computer model that you can make enough changes that it is not simply a matter of punching a button and getting a computer printout, because there are sometimes some highly individualized situations that might be so rare they would not fit into a computer program.

Mr. CLARK. I would agree, Senator. In fact there is a natural fear of the magic black box doing all of these things, and you are right, we will furnish printouts on all of that to the borrower and they can take it home and pencil it out themselves to double check the computations. So yes, I agree, we should tell the world how those things are arrived at and we will be happy to augment that a bit more if you think it is needed.

Senator BOREN. I appreciate it. I do not have any other questions. I will turn to other members of the committee.

Senator Harkin, any further questions?

Senator HARKIN. Thank you, Mr. Chairman. Mr. Clark, I do not want to get back into the socialism issue.

Senator BOREN. I do not know if you were in here, but I said we are not going to carry on with that.

Senator HARKIN. Well, we are not going to carry on with that, but I am going to carry on, Mr. Chairman, with the example you used, Mr. Clark, to buttress your statement on socialism.

You cited two matters: the requirement that Farmers Home stick with farmers for a year even though they are delinquent and give them operating loans for the next year; and the other one was that you cannot use collection agencies like other departments. Those are the two that you mentioned to me here in this open hearing.

Well, when you mentioned those to me, some bells started ringing in my head. I could not quite get it all back together immediately, but now I do after a few minutes of recollection and looking at these documents.

I looked at this proposed rule that FmHA put out just this Monday, September 26, 1988.[1] Now, regarding the requirement the Farmers Home has to stick with this farmer for another year, let me read this to you. This is from your regulation: "On July 11, 1987, the President signed P.L. 100-71. One of the provisions of the act states, in its entirety, as follows: 'Hereafter, funds appropriated or available to the Farmers Home Administration under this or

[1] See pages 658 to 660 for the Proposed Rule.

any other act to make or to service farm loans shall be available for continuing assistance to delinquent borrowers on the basis of the policies contained in Farmers Home Administration Announcement Number 1113-1960, dated November 30, 1984.' "

Let me further read from this proposed rule. "The Administrative Notice to which this legislation refers is AN No. 1113 (1960), which reestablished, for the 1985 crop year, a policy then known as the 'Continuation Policy.' Since 1982, FmHA had policies to make loans to delinquent borrowers, if certain conditions could be met. These policies permitted making new production loans (or subordinating FmHA's liens so that others could make such loans) to borrowers whose delinquent accounts could not be resolved through the use of FmHA's servicing programs."

Now, on the basis of that, Farmers Home under your own regulations provided that farmers who were delinquent could get operating loans under two conditions; one, if they could show they could service that operating loan and that operating loan could be secured, fully secured. That was your regulation from 1982 to 1984.

In November of 1985 the continuation policy was discontinued. This was the policy—the continuation policy—that Chairman Whitten put into the Appropriations bill that became law on July 11, 1987.

Am I correct so far?

Mr. CLARK. Absolutely.

Senator HARKIN. So what you are calling a socialistic policy was implemented by your own agency in 1982, not by the Congress.

Mr. CLARK. They were not regulations, Senator, they were a temporary policy to the field. If indeed we carried it on further, we would have had to put it in the regulations. It was temporarily tried in those years. It did not work. It did not work and we suffered all kinds of losses so we stopped it. Chairman Whitten says, do not stop it, keep going.

Senator HARKIN. I referred to an Administrative Notice dated November 30, 1984, but the policy was put in place in 1982, as I understand it, an announcement in 1982.

I would like to know more from you, information on how it did not work and why it did not work. It is my understanding that the basis of the continuation policy was that you could get an operating loan if you can show you can service that operating loan and if it is fully secured. How did FmHA lose on something like that?

Mr. CLARK. It is only secured by that year's crop, Senator. If that crop goes down the tubes, the yields are not correct, it fails. And the other borrowers might stand by, hoping that it would succeed and keep it going, and take some pay some on their debt, but it did not work.

Senator HARKIN. But, Mr. Clark, that is true of many, many loans the Government makes to farmers that are secured by a crop.

Mr. CLARK. Part of the reason we have an $8 billion delinquency.

Senator HARKIN. So you do not think we should do that any longer?

Mr. CLARK. Not the continuation policy. I would not.

Senator HARKIN. No. I am talking about other loans and programs like that, crop loans and so forth ought to be fully secured by other collateral?

Mr. CLARK. I did not say that.

Senator HARKIN. Well, I said there were other loans that we make to farmers based upon a crop. If they lose it, that is tough luck.

Mr. CLARK. That's agricultural lending. That is the gamble any agricultural lender takes, is to finance that growing crop. If it fails, you are in trouble. You have carryover and you have to try it again in a year and see if it will go on. But somewhere you have to stop, though.

Senator HARKIN. But that is what you were doing, making operating loans. That is what an operating loan is for, 1 year to get that crop in and harvested. That is why agriculture is different from other businesses, Mr. Clark, because you do not know what that weather is going to be and you have to have policies that allow for that.

Mr. CLARK. True.

Senator HARKIN. And it was FmHA's own policy I am pointing to—it wasn't Whitten's law. It was FmHA's own policy from 1982 to 1984 that Whitten made FmHA continue and you say that is a socialistic policy, but FmHA began the policy itself.

Now, let me go on with this continuation policy, because I have looked at these regulations just now and I am quite disturbed by them.

FmHA's discussion of the proposed rule in the September 26, 1988, Federal Register notes that continuation loan policy borrowers had to meet certain conditions. Among the conditions was, to quote from the 1984 Administrative Notice "The borrower has been unable to pay accounts as scheduled."

The 1984 Administrative Notice then gave examples of acceptable reasons why a borrower would be unable to pay accounts as scheduled.

One example was reduction in non-farm income, off-farm job income; the second example was reduction in income due to illness, injury or death; and the third example was reduction income due to natural disaster, an outbreak of uncontrollable disease, and/or uncontrollable insect damage.

Then FmHA states in discussing the proposed rule, "FmHA converted the examples illustrating the second criterion in the 1984 AN into outright limitations."

What FmHA is saying here is that because of the drought this year if we have a farmer delinquent in paying accounts, and we have a continuation policy put into law—FmHA's own policy it had before—now is FmHA saying with these proposed regs that if a farmer suffered from the drought—it wasn't illness, it wasn't reduction of non-farm income, it wasn't an outbreak of infestation or uncontrollable disease—that because of the drought that the farmer would not be eligible for a continuation loan?

Mr. CLARK. We would give him an emergency loan. It would not be a continuation loan.

Senator HARKIN. You wouldn't give him an operating loan, even though he can service the operating loan and it can be secured?

Mr. CLARK. Yes, we would, on an emergency loan basis. We would do that. Continuation, Senator, says you will go on and on. There is no date where you stop, and that is my big argument. When do you say no?

Senator HARKIN. No, that is not right, Mr. Clark. I have to disagree with you. A continuation loan was for the next crop-year. You had to have two things to show. Show that you could service that operating loan and you could secure the operating loan.

It doesn't say I have got to go on the third and fourth year, but it is for the next year.

Mr. CLARK. It does, though. He can go in the next year and ask for the same thing. It isn't only 1 year.

Senator HARKIN. If he can service it and he can secure it.

Mr. CLARK. Yes.

Senator HARKIN. What's wrong with that? If he can service it and he can secure it, what's wrong with that?

Mr. CLARK. Well, you finance him into oblivion. After 10 years he is still not going to make it. How long do you stay there? There should be a date when you say, no more.

Senator HARKIN. No. Obviously if there comes a point where he cannot service it and he cannot secure it, then you do not give it to him.

Mr. CLARK. Well, the continuation says that you will make it because the crop itself services it. That is the income—projected crop income—will secure that loan.

Senator HARKIN. That is right.

Mr. CLARK. Yes.

Senator HARKIN. But if there comes a point where the farmer cannot service it and cannot secure it, then at that point FmHA moves to other issues like mediation and other procedures.

My staff just handed me a note that emergency loans are to cover losses from natural disasters, not to provide continuing operating money.

Mr. CLARK. Well, they do finance next year's crop. Because they have had a loss, it goes on. We give them more money for another emergency loan to carry them into next year.

Senator HARKIN. But emergency loans only cover a percentage of the losses not operating expenses for the next year. But I will not get into that.

Mr. CLARK. Well, that is true.

Senator HARKIN. The second issue was about the use of collection agencies. Again, that rang a bell in my head, too, because I remember sitting just about where you are sitting when this matter broke out.

I remember at the time getting all kind of calls from Iowa, from farmers who had given up their farms, walked away from them and now had jobs in town and they were getting calls from some collection agency out of New Jersey. I remember that now. I had one example of a farmer who received 16 letters. They were calling his boss and harassing him at work. I remember it now. It just took me a while but I had to recollect all of that information.

Now, you say being prevented from using collection agencies is another example of moving toward socialism.

We had a Debt Collection Act that the Government implemented. I do not remember exactly when it was enacted.

Mr. CLARK. 1982.

Senator HARKIN. Early 1980's, 1982. The Debt Collection Act said you had to go through certain procedures before you could use a debt collection agency. The Farmers Home Administration did not. They took these accounts, gave them right to some outfit in New Jersey, I can't remember the name of it. They began cranking out the letters, calling up employers, harassing people at home to pay debts that they had already walked away from, even though they were out trying to make a new life and get a new start some place. That is why we said to Farmers Home, knock it off, do not do it any longer.

Are you telling me that that is a socialistic act to say that you cannot go out and harass people like that? That is what Farmers Home was doing and we said do not do it. If you can comply with the Debt Collection Act, fine, but do not do what you were doing.

Mr. CLARK. The same argument we heard when they made us stop, Senator, the same argument. We did not know that man had left the farm and gone somewhere else. That is what we were trying to determine. We had no contact with him so we hired a collection agency to tell us, is he still there and can he pay? All they had to do is come back and say no and we were ready to charge that off.

Senator HARKIN. So are you saying that you did not want to comply with the Debt Collection Act because the Debt Collection Act did not provide for you to turn those over to a collection agency to allow them to do that?

Mr. CLARK. Not true. We met all the requirements of the Debt Collection Act of 1982. But your arguments are the same we got before and I do not think we will ever resolve that argument between us.

Senator HARKIN. Are you denying that people were harassed, that they were sent dunning letters? I have examples of farmers receiving, maybe, as many as a dozen dunning letters. You do not deny that that happened by that collection agency?

Mr. CLARK. I deny the harassing. I do not believe it. The letters, obviously, that is how they make original contact.

Senator HARKIN. Of course, I would have to reach back now in my files, but employers got calls from this collection agency? You deny that these employers got calls?

Mr. CLARK. I would not deny that. That is a collection agency's role. How do they make contact with the borrowers?

Senator HARKIN. But it is not in conformance with the Debt Collection Act.

Mr. CLARK. Well, I think it is.

Senator HARKIN. You can think it is. Congress said it wasn't.

Mr. CLARK. Well, it is moot, Senator. It is gone. I cannot do it, so I do not know why we are talking about it.

Senator HARKIN. Well, I am talking about it because you said you could not use a collection agency. The fact is you can if you comply with the Debt Collection Act.

Mr. CLARK. No, I cannot.

Senator HARKIN. If you comply with the Debt Collection Act.

Mr. CLARK. No, sir. I cannot at all. That is in the law. They will not let us do it no matter whether I comply or not. We are excluded.

Senator HARKIN. That may be true now but the reason was because you kept violating that act and using the debt collection agency in that manner.

Mr. CLARK. I deny we did that, but, again, the idea is moot, I think.

Senator HARKIN. Well, I do not think it is moot, especially when you say this is one aspect of socialism. You gave two examples of what you meant by that, and this is one of them. Again, we have the data on it, Mr. Clark, and I hope my files will be good enough to find some of the copies of the letters that were sent out by the collection agencies to these people.

That is stretching it to say that it is some kind of a socialistic step to stop that kind of harassment when FmHA was not complying with the Debt Collection Act.

Again, we can go back through that and, as you say, it is moot, but it is not moot if in fact you are using that example or that procedure to then move ahead with new procedures based upon that. Then it is not moot, not moot at all.

Anyway, I just wanted to bring the debt collection policy out because when you said that I remembered it and as far as I am concerned that was a very sordid part of an otherwise very illustrious pattern of conduct by Farmers Home for a great number of years.

I just do not think that policy brought much credit to the Government or to FmHA when that debt collection agency was out there trying to collect those debts.

Under this continuation loan procedure that Mr. Whitten put in the appropriation's bill, how many loans has FmHA made to delinquent farmers? How many to Iowa? I just would like to know how many loans have you had to make to delinquent borrowers under the Whitten provision, which only came in a year ago? If you do not have that information now could you please send it for the record.

Mr. CLARK. I do not have it but I would be happy to submit it for the record. Did you want it by States?

Senator HARKIN. Well, I would like to know Iowa. I do not need to know every State, but I would like to find out, get some examples of that and see what kind of problem you have, if there are indeed problems with it.

[The material follows:]

ANNUAL PRODUCTION LOANS TO DELINQUENT BORROWERS

Source: FmHA Report Code 205C 9/28/88 FY 1988

State	Number of Loans	$ Obligations	Average Loan Amnt
Alabama	4	170,290	42,573
Alaska	1	15,400	15,400
Arizona	0	0	0
Arkansas	24	963,390	40,141
California	0	0	0
Colorado	3	101,760	33,920
Connecticut	0	0	0
Delaware	0	0	0
Florida	1	47,000	47,000
Georgia	3	196,330	65,443
Hawaii	0	0	0
Idaho	9	441,860	49,096
Illinois	15	357,180	23,812
Indiana	15	591,550	39,437
Iowa	6	99,700	16,617
Kansas	13	667,400	51,338
Kentucky	19	289,370	15,230
Louisiana	19	835,980	43,999
Maine	1	37,600	37,600
Maryland	0	0	0
Massachusetts	0	0	0
Michigan	15	400,110	26,674
Minnesota	0	0	0
Mississippi	20	1,221,380	61,069
Missouri	8	241,550	30,194
Montana	9	197,400	21,933
Nebraska	3	49,600	16,533
Nevada	0	0	0
New Hampshire	0	0	0
New Jersey	0	0	0
New Mexico	0	0	0
New York	0	0	0
North Carolina	29	1,222,990	42,172
North Dakota	26	967,910	37,227
Ohio	0	0	0
Oklahoma	12	192,190	16,016
Oregon	6	477,400	79,567
Pennsylvania	4	150,000	37,500
Rhode Island	0	0	0
South Carolina	2	39,500	19,750
South Dakota	3	15,500	5,167
Tennessee	10	325,550	32,555
Texas	27	783,950	29,035
Utah	1	72,530	72,530
Vermont	0	0	0
Virginia	10	287,680	28,768
Washington	0	0	0
West Virginia	0	0	0
Wisconsin	5	178,850	35,770
Wyoming	1	32,500	32,500
Puerto Rico	0	0	0
Virgin Islands	0	0	0
West Pacific Terr	0	0	0
U. S. Total	324	11,671,400	36,023

Senator HARKIN. Mr. Chairman, I had some more questions. I do not mean to take more of the committee's time. I wanted to ask some questions on income release.

How many borrowers requested income release when you sent out the initial notices last spring and how many denials have there been on income release? Again that is something I would like to know.

Mr. CLARK. Well, approximately 1,200 have been released, Senator; few if any denials. We approved all of those.

Senator HARKIN. I am also concerned about shared appreciation. I think, Mr. Chairman, if I just ask consent to submit some questions in writing for the record to the Administrator and ask that they be responded to and not take any more of your time.

Senator BOREN. All right. Those questions will be received for the record and replied to for the record.

Let me say, again, Mr. Clark, I have no further questions. The bottom line is that overall I think we have made some good progress with these regulations. Overall I am pleased with these regulations. I appreciate the clarification on the voluntary mediation program—the correction of the typographical error. I am reassured about that.

I am pleased that we will soon have the demonstration project regulations in place and also pleased by your answer about sharing the computer programming of the computer printouts and the way the programs are put together with the farmer and also your sensitivity to making sure that they are flexible. And I am glad that many changes have been made from the drafts that you refer to in your statement and others we have talked about.

Senator HARKIN. May I interrupt in that. That did ring another bell, Mr. Chairman. Were you talking about the DALAR$ computer program, making that available?

Senator BOREN. Yes.

Senator HARKIN. I did have a question about that. Evidently it was talked about when I was outside the room.

Senator BOREN. Well, go ahead and address your question.

Senator HARKIN. Well, as I understand, FmHA had the DALAR$ program set up but the program is not available to groups out there working with these farmers and it is not compatible with other systems.

It is on a system called UNIX system that is not compatible with the MSDOS system that we have here.

So what that means is that in preparing to submit applications and proposals for the DALAR$ program, farmers do not know how to submit them because they do not know how to conform to the program because it is not compatible.

Senator BOREN. I do not know. We did not get specifically into the question of the incompatibility of the systems.

Senator HARKIN. This is a very important point. The Credit Act puts the burden on the borrower to bring the Farmers Home a, quote, "preliminary plan" to show that debt restructuring will work for this farmer. While Farmers Home requires the borrower to provide this data, it is not clear to the borrower how the computer program will work.

Farmers Home in Iowa told my staff that the program is not available to the public and it is not compatible to plug into other systems. No one in the private sector has access to a UNIX system and it is not compatible with our MSDOS system.

Therefore, farm financial preparers working with these farmers will be unable to prepare proposals to fit the FmHA computer program. So potential financial outcomes may be developed by a computer that are contingent upon what is fed into the computer, but if we do not know what the computer programs are and the financial preparers working with the farmers do not know what the programs are, how are they going to prepare it? It may not fit the model.

Mr. CLARK. Well, again, our program is designed for our AT&T equipment at Farmers Home and USDA. It was not designed to be compatible and not designed to not be compatible. That is the program we are using. It would cost an awful lot of money to try to duplicate that program for all MSDOS or UNIX or whatever.

But I must tell you, again, I do not know how many farmers have computers on our borrowers' rolls to come in. When they give us the numbers, we will sit down with them right there and plug them in and they can watch it work. And then we give them the hard copies, Mr. Chairman, and as I say, they can go back and look at those hard copies and double check that computation in any way they like, either through computer applications or a hand calculator.

Incidentally, we are going to share that program, particularly with the bankers. We think the American Bankers Association ought to see it, too. They have a meeting in Des Moines, I think, in November, and we will probably take that equipment out there to show them how that works. But it is not secret. We will give the diskette to anybody who wants to try it on their equipment.

Senator HARKIN. Fine. I was going to request that you make that available.

Mr. CLARK. Sure, we will be happy to.

Senator HARKIN. If you will make that available, fine.

Senator BOREN. Well, again, thank you for appearing this morning. I know you will look forward for the next invitation from us to come and join us here. [Laughter.]

But in all seriousness, I hope you will convey to those at the agency who spent extra hours of overtime getting these regulations in place that I think we have had some very significant progress on the regulations. I think that many of the things in the regulations are a substantial improvement. I think we have basically got a good set of regulations here on paper and I think what we all want to do now is just all work together as hard as we can to make sure that these regulations are really carried out, and that everybody up and down the line goes to work to see that that happens. I think that is our challenge and that is something that will be beneficial for the farmers and the taxpayers both.

Mr. CLARK. Thank you, Mr. Chairman. I appreciate your courtesy. You will have to hurry up and invite me back. I am going to go back to my home and retirement come December 1. Mr. Harkin will be pleased about that, I am sure. But I appreciate your courtesies.

Thank you.

Senator BOREN. Thank you. We wish you well as you go back home.

Mr. CLARK. Thank you.

[Material for the record follows:]

PATRICK J. LEAHY, VERMONT, CHAIRMAN

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United States Senate

COMMITTEE ON
AGRICULTURE, NUTRITION, AND FORESTRY
WASHINGTON, DC 20510-6000

December 5, 1988

Mr. Vance L. Clark
Administrator
Farmers Home Administration
U.S. Department of Agriculture
14th Street and Independence Avenue, N.W.
Washington, D.C. 20250

Dear Mr. Clark:

Thank you for testifying before the Subcommittee on Agricultural Credit on September 30, 1988. You will recall that I indicated at the hearing that I would submit additional questions in writing for you to answer for the record. You will find those questions enclosed. Please supply your answers as soon as possible so that the hearing record may be completed and printed.

Thank you for your cooperation.

Sincerely yours,

Tom Harkin

Tom Harkin
United States Senator

U.S. SENATE AGRICULTURE
SUBCOMMITTEE ON CREDIT

Farmers Home Administration
Oversight Hearing

Questions Submitted by Senator Tom Harkin

I. MEDIATION

Issue--What triggers FmHA's mandated participation in a "voluntary" mediation state? The 1987 Ag Credit Act states that FmHA "shall . . . participate in (USDA-certified, state) agricultural loan mediation programs." (Sec. 503). The Act also states:

> "the Secretary . . . shall prescribe rules requiring each such (federal program under the Secretary's jurisdiction) program to participate in good faith in any State's agricultural loan mediation program." (Sec. 503).

What does this mean in a state with a USDA-certified voluntary mediation program? Basically, there are three choices:

1. FmHA must initiate mediation proceedings before it can proceed with foreclosure.

2. FmHA may participate only if it wants to.

3. FmHA must participate in mediation proceedings if requested by a delinquent borrower.

I believe Choice 3 fairly describes FmHA reasonable obligation in a state with a voluntary mediation program.

Choice 1 describes FmHA's obligation in a state with mandatory mediation, and there is no indication that Congress intended FmHA to play mandatory mediation's pre-foreclosure initiating role in states which chose voluntary mediation instead of mandatory mediation.

Choice 2 is apparently FmHA's position in voluntary mediation states. (53 Fed. Reg. 166, p. 32597, Aug. 26, 1988 and 53 Fed. Reg. 178, p. 35736, Sept. 14, 1988). FmHA tries to justify its position by saying the law (cited above) mandates participation in a mediation program NOT an actual mediation session. This position frustrates the Section 503 language and allows FmHA to ignore mediation sessions in at least ten states which have voluntary programs (IN KS NE MS MT ND OK WI WY TX). Mr. Vance Clark's testimony

at Senate ag credit subcommittee hearing on September 30 did not clear this up. He stated that the Federal Register contained a "typographical error"--"requested" should read "required." While this is a useful wording clarification, it does not explain away the policy statements described above.

The only logical interpretation of Section 503's mandated participation in voluntary mediation programs is Choice 3: FmHA must participate in a mediation session if the borrower request a mediation session. NOTE: This does not mean FmHA must initiate a mediation session (Choice 1 above). Choice 3 would give meaning to both federal and state law.

QUESTIONS:

1. In the ten states with voluntary mediation, will FmHA participate in mediation sessions if requested by the borrower (through the USDA-approved mediation service)?

2. If so, can regulations be changed to make this clear?

3. If not, what would trigger FmHA's participation in an actual mediation session? Under what criteria would FmHA refuse to participate in a mediation session if requested?

4. In voluntary mediation states, would FmHA be willing to include announcements about the availability of mediation in appropriate letters being otherwise sent to distressed FmHA borrowers?

5. Why has FmHA taken the position that a state may not have more than one certified program if there is already a limit on the amount of federal funds which a state may receive? Should not the state be able to decide the form which their mediation program takes?

II. JOINT FmHA/FCS "DEMONSTRATION PROJECT"

Issue--Timely cooperation between FmHA local offices and FCS certified institutions: Jointly administered programs have double the chance for delay and maladministration. In fact, more than double, because each implementing entity can point a finger at the other as the cause of any implementation problem instead of correcting its own side of the problem. Mr. Clark's testimony at the September 30th hearing took this fingerpointing posture: "We . . . are ready to go with this as soon as they (FCS institutions identify the inventory being targeted for this program and furnish to us their appraisal information."

For their part, local Omaha FCS officials indicate that they are ready to go as soon as FmHA adopts its final demonstration project regulations. As a technical matter, the Omaha Bank officials are correct. As a practical matter, I fear that the fingerpointing could continue step after step. As members of the Senate ag credit subcommittee know very well, the Omaha Bank officials' disregard of the Act's certification requirements involved three-way fingerpointing among the Omaha FLB, the FCS Assistance Board and FCA. The Omaha FLB's failure to request certification was always someone else's responsibility. The demonstration project is timely now: with each month more opportunities are lost as the Omaha Bank and other currently certified institutions (Louisville and Jackson) and to-be certified institutions (St. Paul FCB) continue selling inventory land.

Mr. Clark's above quoted statement addresses the need to receive identification of inventory land targeted for the demonstration project and appraisal information. Such a process is presumably a reference to the demonstration project law which states:

> "Farm Credit System institutions shall--"(B) to the extent practicable, set aside each fiscal year land acquired or owned by such institutions of the Farm Credit System in an aggregate amount not to exceed $250,000,000 at fair market value, for purchase by eligible borrowers in accordance with this subsection;" (Section 613)

Neither the joint FmHA/FCS memorandum of understanding nor FmHA's proposed regulations make mention of this identification/appraisal process.

However, Congress has charged the Secretary with overall responsibility for the program (". . . the Secretary shall establish and carry out a demonstration project. . ."). With the ongoing need to get this program underway and in light of Mr. Clark's suggestion that the FCS, not FmHA, is now the bottleneck, I would like to raise the following questions.

QUESTIONS:

1. In the case of the now-certified Omaha FCS, who is responsible for providing the identification and appraisal mentioned by Mr. Clark in his testimony to FmHA? (FCA? the Omaha FCS, the FCS Assistance Board?)

2. When must that responsible FCS institution provide that information? How soon after certification must it (they) supply it?

3. If the responsible FCS institution fails to provide this information, whose responsibility is it to enforce this procedure?

4. Whose responsibility is it to determine if a particular FCS institution has set aside acquired property "to the extent practicable"?

5. Could you describe what the next step in the demonstration project will be after FmHA receives the identification and appraisals mentioned by Mr. Clark? What will FmHA's responsibility be after the identification and appraisals are received by FmHA?

6. In particular, how will the availability of demonstration project land be announced? How will potentially eligible buyers be recruited?

III. CONSERVATION EASEMENTS

Issue--Calculating debt forgiveness: The Act changed the formula for the calculation of the amount of debt to be forgiven in return for the granting of a conservation easement. However, FmHA's interim regulations either do not reflect this change or their interpretation of it makes the amendment meaningless. Congress did not intend for the amendment to make more restrictve the amount of debt to be cancelled but that is what FmHA's regulations do. The correct procedure for determining the amount of debt to be forgiven follows on this page.

QUESTION:

How does FmHA justify the regulatory calculation for the amount of debt to be forgiven under the conservation easement program considering the 1987 change to the law governing this program?

1951.950 - The proposed exhibit completely and totally misstates the calculation with regard to the amount of debt to be forgiven under a conservation easement. FmHA must either be unaware the law was changed by the Agricultural Credit Act of 1987 or plans to ignore its language.

The correct amount of debt to be forgiven in the cited example is $90,000. This is arrived at through the following calculation:

Total acreage - 300 acres	FmHA debt - $450,000
Easement acreage - 60 acres	Land value - $1,000/acre

Step 1 - Determine current market value per acre of farm, times number of easement acres. $60,000

Step 2 - Determine difference between amount of FmHA loan and current market value of farm. $150,000

Step 3 - Take higher value of Step 1 or 2. $150,000

Step 4 - Determine proportion of easement acres to total number of acres. Use same proportion on total amount of debt. $90,000

Step 5 - Take lesser of amounts in Step 3 or 4. $90,000

The amount to be forgiven, therefore, is $90,000. The exhibit must be changed to reflect this corrected procedure.

(See excerpt attached from the Federal Register of Wednesday, September 14, 1988.)

IV. GUARANTEED LOANS

Issue--Farmers Home Administration has not yet published final regulations on the changes in the guaranteed loan program. (Sec. 357) It is my understanding that FmHA and the lender must first consider the interest rate buy-down on guaranteed loans before foreclosure action may be initiated. Yet the interest rate buy-down is not now available by FmHA's directive until the new regulations are published. Not only are lenders left hanging by this delay, borrowers cannot be considered for interest rate reduction, and the demonstration project has yet another road block in the way of implementation.

QUESTIONS:

1. What commitment can FmHA give to quickly finalize regulations on Sec. 357 of the Act?

2. How many guaranteed loans are delinquent? What percentage of total loans are delinquent? How many guaranteed loans were liquidated in 1987? 1988? How many payoffs were there in 1987? 1988?

3. What is the length of time a borrower may be eligible for interest rate buy-down? What statutory authority has FmHA used to limit the buy-down to 3 years?

4. Since 1985, how much of the interest rate buy-down allocation has been obligated by FmHA? Please provide a yearly breakdown, including 1988 to date.

5. The 1987 legislation specifically requires consideration of interest rate buy-down 60 days prior to foreclosure. If this period has expired, while regulations are being finalized, should not the loan be considered for buy-down prior to liquidation?

V. CONTINUATION LOANS

How many loans has FmHA made to delinquent farmers in Iowa based on the Whitten Amendment? In the U.S.?

VI. FORBEARANCE

What formal policy has FmHA developed to assist borrowers affected by the drought? FmHA has, by Administrative Notice, discontinued rollover of debt. What procedure will FmHA implement for borrowers who are unable to make full payment due to the drought. Please provide Administrative Notices and any other documentation sent to State and County office.

FEDERAL REGISTER, Vol. 53, No. 178
Wednesday, September 14, 1988
Reproduced from Pages 35751-52

VII. Determining the amount of farmer program debt that can be cancelled.

(A) *Calculate the amount of debt to be cancelled as follows:*

(1) *Step 1.* Determine what percent the number of easement acres is of the total acres of land that secures the borrower's farmer program loans by dividing the easement acres that secure the borrower's farmer program loans by the total acres that secure the borrower's farmer program loans.

(2) *Step 2.* Determine the amount of farmer program debt that is secured by the easement acreage by multiplying the borrower's total unpaid farmer program loan balance (principal, interest and recoverable costs already paid by FmHA) by the percentage calculated in Step 1.

(3) *Step 3.* Determine the current value of the land in the easement by multiplying the present market value of the farm that secures the borrower's farmer program loans by the percent calculated in Step 1.

(4) *Step 4.* Select the lesser of the values calculated in Steps 2 and 3.

(5) *Step 5.* Subtract the current value of the easement acres in Step 3 from the farmer program debt that is secured by the easement acres in Step 2.

(6) *Step 6.* Select either the value arrived at in Step 4 or 5, whichever is the greater.

An Example For Determining The Amount That Can Be Cancelled:

Situation

Total Acres, 300
Easement Acres, 60
Amount of unpaid farmer program debt secured by farm, $450,000
Current value of farm, $300,000
Step 1. 60 easement acres; 300 total acres = 20 percent
Step 2. $450,000 debt x 20 percent, Step 1 = $90,000
Step 3. $300,000 value x 20 percent, Step 1 = $60,000
Step 4. Select the lower amount of Step 2 or Step 3 Calculations = $60,000
Step 5. $90,000 in Step 2—$60,000 in Step 3 = $30,000, Amount FmHA is undersecured on Easement Land
Step 6. Select the greater of Step 4 or 5 = $60,000
$60,000 of the debt would be the maximum amount available for the debt cancellation.

United States Department of Agriculture
Farmers Home Administration
Washington D.C. 20250

DEC 22 1988

Honorable Tom Harkin
United States Senate
Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Harkin:

The enclosed is in response to the questions you submitted to us in your letter of December 5, 1988. We hope this material will help to complete the record for the hearing held on September 30 by the Subcommittee on Agricultural Credit. Please let us now if you need additional information.

Sincerely,

LA VERNE AUSMAN
Acting Administrator

Enclosures

FmHA Farmers Home Administration is an Equal Opportunity Lender
Complaints of discrimination should be sent to
Secretary of Agriculture, Washington, D.C. 20250

U. S. DEPARTMENT OF AGRICULTURE
Farmers Home Administration

ANSWERS TO ADDITIONAL QUESTIONS
FROM THE SUBCOMMITTEE ON AGRICULTURAL CREDIT
TO COMPLETE HEARING TESTIMONY HELD
SEPTEMBER 30, 1988

I MEDIATION

QUESTION 1: In the ten states with voluntary mediation, will FmHA participate in mediation sessions if requested by the borrower (through the USDA-approved mediation service)?

ANSWER: Yes. In any state, with either voluntary or USDA certified mediation programs, FmHA will request mediation or a meeting with the borrower and his undersecured creditors whenever FmHA is unable to restructure the borrowers debts to permit the development of a feasible plan after considering all primary servicing options. FmHA will participate in mediation sessions whether initiated through an FmHA request, other creditors or a request from the borrower. Participation will be under the same terms and conditions as other creditors.

QUESTION 2: If so, can regulations be changed to make this clear?

ANSWER: The FmHA interim final regulations implementing FmHA's participation in mediation are clear and firm on this issue. If any discrepancy should arise down the line, the policy could be reinforced to the field by the Administrator.

QUESTION 3: Under what criteria would FmHA refuse to participate in a mediation session if requested?

ANSWER: FmHA will participate in USDA certified mediation sessions whether initiated by the agency, another creditor or requested by the borrower as long as participation is based on the same terms and conditions as all other creditors.

QUESTION 4: In voluntary mediation states, would FmHA be willing to include announcements about the availability of mediation in appropriate letters being otherwise sent to distressed FmHA borrowers?

ANSWER: Yes. All farmer program borrowers will be notified by certified mail that FmHA is requesting mediation when the agency is unable to restructure the borrowers debts to consider the development of a feasible plan of operation.

QUESTION 5: Why has FmHA taken the position that a state may not have more than one certified program if there is already a limit on the amount of federal funds which a state may receive? Should not the state be able to decide the form which their mediation program takes?

ANSWER: FmHA does not believe more than one certified mediation program would be efficient or practical. However, if a state wishes to request certification of more than one mediation program, USDA will comply provided they meet all eligibility criteria.

II. JOINT FmHA/FCS "DEMONSTRATION PROJECT"

QUESTION 1: In the case of the now-certified Omaha FCS, who is responsible for providing the identification and appraisal mentioned by Mr. Clark in his testimony to Committee (FCA?, the Omaha FCS, the FCS Assistance Board?)

ANSWER: Each Farm Credit System that has been certified for assistance by the Assistance Board will identify properties for the FmHA demonstration project and provide a current appraisal of the property.

QUESTION 2: When must that responsible FCS institution provide that information? How soon after certification must it (they) supply it?

ANSWER: The Act does not set forth any time frame for the FCS to provide information on farms for the Demonstration project.

QUESTION 3: If the responsible FCS institution fails to provide this information, whose responsibility is it to enforce this procedure?

ANSWER: It is the FCS's responsibility to identify properties for participation in the pilot program. The FmHA responsibility is to process guaranteed loan applications for the purchase of those farms identified by the FCS for the pilot project. There is no enforcement authority per se.

QUESTIONS 4: Whose responsibility is it to determine if a particular FCS institution has set aside acquired property "to the extent practicable"?

ANSWER: It is the Farm Credit Administration's responsibility to make a determination of each bank's use of this new authority.

QUESTION 5: Could you describe what the next step in the demonstration project will be after FmHA receives the identification and appraisals mentioned by Mr. Clark? What will FmHA's responsibility be after the identification and appraisals are received by FmHA?

ANSWER: After the farms are identified and the appraisals are received, FmHA will expeditiously process the guaranteed loan applications that are received from lenders.

QUESTION: 6: In particular, how will the availability of the demonstration project land be announced? How will potentially eligible buyers be recruited?

ANSWER: An agreement will be signed between each District Bank and the Administrator of FmHA. This agreement provides that each "Bank and FmHA are independently responsible for providing adequate media coverage of the FCS Demonstration Project. Media coverage will include news releases for local newspapers, radio, and television."

III. CONSERVATION EASEMENTS

QUESTION: How does FmHA justify the regulatory calculation for the amount of debt to be forgiven under the conservation easement program, considering the 1987 change to the law governing this program?

ANSWER: Section 1318 of the Food Security Act of 1985, as amended by Section 612 of the Agricultural Credit Act of 1987, clearly states that the amount of debt to be cancelled will always be based on the ratio of the easement acres to the total acres in the entire farm, regardless of whether the amount is based on the value of the land in the easement or on the amount of unsecured debt on the easement acres. In your example, the value of the entire farm and the amount of the entire debt against it was used to determine the amount of debt cancellation. Whereas, the acres of land in the easement and the prorated value of those acres compared to the total acres in the farm should be used to determine the amount of the debt cancelled.

IV. GUARANTEED LOANS

QUESTION 1: What commitment can FmHA give to quickly finalize regulations on Sec. 357 of the Act?

ANSWER: The Guaranteed Regulations implementing Section 357 of the Agricultural Credit Act of 1987 are in the final stage of the clearance process and expected to be published in the Federal Register as final rule in the near future. We are working closely with OMB to get their clearance which is necessary for publishing in the Federal Register.

QUESTION 2: How many guaranteed loans are delinquent? What percentage of total loans are delinquent? How many guaranteed loans were liquidated in 1987? 1988? How many payoffs were there in 1987? 1988?

ANSWER: As of September 30, 1988, 1,388 guaranteed loans were delinquent. This amounted to 3.9 percent of the total number of guaranteed loans outstanding. There is no current report which records the number of liquidated guaranteed loans each year. Many guaranteed loans are liquidated and paid in full and do not result in loss claims. In FY 87, $123,143,094 was paid on 900 loss claims. In FY 88, $98,639,275 was paid on 1190 loss claims.

QUESTION 3: What is the length of time a borrower may be eligible for interest rate buydown? What statutory authority has FmHA used to limit the buydown to 3 years.

ANSWER: Three years is the maximum term for which an interest rate buydown agreement can be written. This is provided for in Section 352(d) (7 U.S.C. 1999) of the Consolidated Farm and Rural Development Act. In the case of the Demonstration project, the interest rate buydown will be for 5 years as provided by Section 351(h) (4)(7 U.S.C. 1999).

QUESTION 4: Since 1985, how much of the interest rate buydown allocation has been obligated by FmHA? Please provide a yearly breakdown, including 1988 to date.

ANSWER:

	Allocated	Obligated
FY 86	$114,840,000	$10,044,294
FY 87	290,267,765	22,424,752
FY 88	185,000,000	16,515,490

QUESTION 5: The 1987 legislation specifically requires consideration of interest rate buydown 60-days prior to foreclosure being initiated. If this period has expired, while regulations are being finalized, should not the loan be considered for buydown prior to liquidation?

ANSWER: FmHA extended the Interest Rate Buydown Program on November 9, 1988. This program was not available between September 30, 1988, and November 9, 1988. Since this period was less than 60-days, no such problem has been brought to our attention.

V. CONTINUATION LOANS

QUESTION: How many loans has FmHA made to delinquent farmers in Iowa, based on the Whitten amendment? In the U.S.?

ANSWER: As of September 30, 1988: 7 continuation loans and 16 continuation subordinations were approved in the State of Iowa; and for the nation, 482 loans and 428 subordinations were approved.

VI. FORBEARANCE

QUESTION: What formal policy has FmHA developed to assist borrowers affected by the drought?

ANSWER: It has always been FmHA policy and practice to give borrowers, who have acted in good faith, the benefit of forbearance through the use of rescheduling, reamortization and deferrials of loan payments due FmHA, when the circumstances causing the inability to pay are beyond the borrower's control. FmHA will continue to exercise such forbearance as set forth in the authority granted to FmHA. Regulations implementing the provisions of the Agricultural Credit Act of 1987 have been published as interim final rules and applications are being received and processed in FmHA County Offices. Primary and preservation loan servicing programs as provided for in these regulations represent the ultimate in forbearance. We expect that any farmer who has acted in good faith in his dealings with FmHA and who has demonstrated adequate management skills and production capabilities will have every opportunity to remain in farming.

The FmHA field staff will continue to work with guaranteed lenders and place emphasis on encouraging them to forbear with their borrowers by extending the maximum terms and lowest interest rates possible.

FEDERAL REGISTER, Vol. 53, No. 186
Monday, September 26, 1988
Reproduced from Pages 37317-19

DEPARTMENT OF AGRICULTURE

Farmers Home Administration

7 CFR Part 1941

Proposed Revisions to Provisions of the Supplemental Appropriations Act

AGENCY: Farmers Home Administration, USDA.

ACTION: Proposed rule with request for comments.

SUMMARY: The Farmers Home Administration (FmHA) proposes to amend its authority that became effective on March 16, 1988, for making annual production loans to delinquent borrowers. This action is taken as a means of affording the public an opportunity to consider three changes concerning the making of annual operating (OL) loans to delinquent borrowers for production purposes, or the granting of subordinations, to delinquent borrowers to enable them to obtain annual operating credit from another lending source. The first change would revise the standards for eligibility for these loans. The second change would ease the requirements for obtaining non-disturbance agreements. The third change would prohibit such loans to borrowers who have been considered for loan restructuring (writedown of FmHA debt) under the provisions of new subpart 1951-S of the agency's regulations.

DATE: Written comments must be submitted on or before October 26, 1988.

ADDRESS: Submit written comments, in duplicate, to the Office of the Chief, Directives and Forms Management Branch, Farmers Home Administration, USDA, Room 6348, South Agriculture Building, 14th Street and Independence Avenue SW., Washington, DC 20250. The Regulatory Impact Analysis Statement (RIA) and all written comments made pursuant to this notice, will be available for public inspection during regular working hours at the above address.

FOR FURTHER INFORMATION CONTACT: Mark Falcone, Senior Loan Officer, Farmer Programs Loan Making Division, Farmers Home Administration, USDA, South Agriculture Building, 14th Street and Independence Avenue SW., Washington, DC 20250, telephone (202) 475-4019.

SUPPLEMENTARY INFORMATION:

Classification

This action was reviewed under USDA procedures established in Department Regulation 1512-1, which implements Executive Order 12291, and was determined to be major because it will result in an annual effect on the economy of $100 million or more.

Summary of RIA

The USDA developed a Regulatory Impact Analysis (RIA), which was summarized in the final rule, and was published in the **Federal Register** (53 FR 8738-8740) dated March 16, 1988. Any changes that may be made as a result of this proposed rule could have an impact on the RIA. If so, the RIA will be revised when the final rule is published.

Intergovernmental Consultation

For the reasons set forth in the final rule related to Notice 7 CFR Part 3015, Subpart V (48 FR 29115, June 24, 1983) and FmHA Instruction 1940-J, "Intergovernmental Review of Farmers Home Administration Programs and Activities" (December 23, 1983), Farm Operating Loans are excluded from the scope of Executive Order 12372, which requires intergovernmental consultation with State and local officials.

Programs Affected

These changes effect the FmHA operating loan program, as listed in the Catalog of Federal Assistance:

10.406—Farm Operating Loans.

Environmental Impact Statement

This document has been reviewed in accordance with 7 CFR Part 1940, Subpart G, "Environmental Program." It is the determination of FmHA that the proposed action does not constitute a major Federal action significantly affecting the quality of the human environment, and in accordance with the National Environmental Policy Act of 1969, Pub. L. 91-190, an Environmental Impact Statement is not required.

Discussion of Proposed Rule

The regulations authorizing the making of annual operating loans or granting subordinations to delinquent borrowers were published to comply with a provision in Chapter X of Title I of the Supplemental Appropriations Act for 1957 (Pub. L. 100-71), dated July 11, 1987. Three changes are being considered. The first would change the existing "conditions" for eligibility to examples. The second would make less restrictive the need to obtain non-disturbance agreements. These proposed changes are based on public expressions that the existing regulation is more restrictive than the policy in effect under FmHA Administrative Notice (AN) No. 1113 (1960, dated November 30, 1984, to which the law required FmHA must adhere. The third proposed change would amend the regulations by restricting eligibility of these loans to only those borrowers whose accounts have not had the benefit of being fully considered for restructuring, pursuant to Subpart S of Part 1951. That regulation, which itself was published as a proposed rule on May 23, 1988, provides major debt restructuring alternatives for delinquent FmHA farm loan borrowers, including a debt write-down program, which provides a long-term solution rather than a short-term solution for delinquent borrowers.

On July 11, 1987, the President signed Pub. L. 100-71. One of the provisions of the Act, (in Chapter X of Title I, 101 Stat. 429) states, in its entirety, as follows:

> Hereafter, funds appropriated or available to the Farmers Home Administration under this or any other Act to make or to service farm loans shall be available for continuing assistance to delinquent borrowers on the basis of the policies contained in Farmers Home Administration Announcement Number 1113-1960, dated November 30, 1984.

The Administrative Notice to which this legislation refers is AN No. 1113 (1960), which reestablished, for the 1985 crop year, a policy then known as the "Continuation Policy." Since 1982, FmHA had policies to make loans to delinquent borrowers, if certain conditions could be met. These policies permitted making new production loans (or subordinating FmHA's liens so that others could make such loans) to borrowers whose delinquent accounts

could not be resolved through the use of FmHA's servicing programs. In November 1985, the Continuation Policy was discontinued.

Under the Continuation Policy, FmHA had refrained from foreclosure or other debt collection processes for those borrowers who received new loans, until after those new loans became due and payable. Those borrowers who received loans under that policy, came to be known as Continuation loan policy borrowers; and they had to satisfy certain conditions. Among those conditions were, to quote from the 1984 AN:

"2. The borrower has been unable to pay accounts as scheduled. Examples of this would be:

A. Reduction in essential income from a nonfarm job due to unemployment or underemployment of the borrower-operator or spouse caused by circumstances beyond the borrower's control; or

B. Reduction in income due to illness, injury or death of an individual borrower, or, in the case of an entity borrower, the stockholder, member or partner who operates the farm; or

C. Reduction in income due to a natural disaster(s), an outbreak of uncontrollable disease, and/or uncontrollable insect damage which caused severe loss of agricultural production that reduced the repayment ability of the borrower to the degree that scheduled payments cannot be made."

On November 16, 1987, FmHA published proposed regulations for public comment concerning this section of Pub. L. 100-71 (52 FR 43766-68). In the proposed regulations, FmHA converted the examples illustrating the second criterion in the 1984 AN into outright limitations. The proposed rule stated: "2. The borrower has been unable to pay accounts as scheduled due to :", and then set out the language of the three examples.

FmHA made this change of language in an attempt to use clearer language and better form in its new regulations than it had used in the 1984 AN. This change in wording was not thought to establish a substantive difference from the progrm existing as a result of the 1984 AN, since the 1984 "examples" were intended to be interpreted as conditions. It was thought that using the language in the proposed rule would be more effective than republishing the 1984 AN itself, since the law refers to the "policies" contained in the 1984 AN, as well as to the AN itself.

No comments were received on this point during the 30-day comment period following the publication in the Federal Register of the proposed regulation; and the Agency reviewed those comments it did receive and published its final rule on this subject on March 6, 1988.

Shortly before the final rule was published in the **Federal Register**, however, the Administrator received a letter from a member of the public alleging that the replacement of the "examples" with conditions in the proposed rule (which feature was incorporated into the final rule) made the regulations more restrictive than the 1984 AN. Specifically, this letter argued that:

"The AN merely lists three examples of reasons why the borrower has been unable to pay his/her account. In the proposed regulations, those three examples are converted into rules. The proposed regulations narrow the AN by providing that a borrower may be eligible for assistance under this policy only if his/her inability to pay was caused by one of those three reasons. Certainly, it is impermissible for the final regulations to be more restrictive than AN 1113.1980."

The same member of the public made some extensive comments on the proposed FmHA regulations published in the **Federal Register** on May 23, 1988. These regulations were published as a result of the Agricultural Credit Act of 1987. Several of the comments mentioned referred to FmHA Institution 1941-A, § 1941.14, Annual production loans to delinquent borrowers. All of FmHA's Farmers Program regulations were published in the proposed regulations, even though some sections, including the above mentioned section, had no proposed changes.

In addition to the repeated comment requesting FmHA to change condition to "examples", the commenter in another letter, dated June 21, 1988, also requested FmHA to expand the "Continuation Policy" to include the following:

(1) Notify all delinquent borrowers who inquire about or submit applications for operating loans or subordinations, by letter, about the availability of such loan to delinquent borrowers.

(2) Automatically reconsider assistance under this program to all borrowers whose applications for operating loans or subordinations have been denied since July 11, 1987 (the date of enactment of this authority).

(3) Change the present sentence on non-distrubance agreements to the way it was stated in AN No. 1113 (1980).

FmHA does not plan to adopt the first comment as it is not necessary to notify delinquent borrowers about the program. If they apply for assistance and cannot show repayment on all their debts after considering all servicing options, County Supervisors will automatically consider their applications for this program.

FmHA does not plan on adopting the second comment, as the regulations and the 1984 Administrative Notice (AN) do not have retroactive provisions. There is no indication that the law contemplates or requires retroactive consideration.

FmHA does plan to adopt the third comment so as not to place a greater burden on the farmer than the requirements in AN No. 1113 (1960).

Any comments submitted on this proposed rule should provide as much evidence as possible on the impact of the program as it was implemented in 1984 and 1985 in the commenter's State or locality. The statute specifically requires FmHA to adopt the "policies" that were used in 1984-1985 to administer this special loan authority; and the goal is thus to adapt the rules for use in 1988 and beyond as nearly as possible to the practices in effect at that time.

Another purpose of this notice is to propose an amendment to the existing regulations which will limit the availability of "Continuation Loans" to only those farm borrowers whose loans and accounts have not been fully considered for restructuring, in accordance with Subpart S of Part 1951, which regulation contains provisions of section 353 of the Consolidated Farm and Rural Development Act (CONACT). This portion of the CONACT was added as a result of section 615 of the Agricultural Credit Act of 1987, Pub. L. 100-233. As stated in the proposed rule, published in the **Federal Register**, (53 FR 18392-18523) on May 23, 1988, FmHA plans to accelerate the borrower's account once a final decision has been made that the borrower is not eligible for debt write-down. Debt write-down is a provision of Pub. L. 100-233. Present FmHA regulations state that once a borrower's account is accelerated, the borrower will not be considered for a Continuation Loan.

When the Continuation Policy was first established in 1982, it was intended to operate for only one year. However, the policy was extended one year at a time, with some modifications, as a "temporary" solution, for each of the 1983, 1984, and 1985 production years. In all three of those years, it was expected the financial condition of borrowers would improve in the subsequent year, or that a new law(s) would be enacted which would enable resolution of the financial difficulties of these borrowers. For this reason, FmHA did not, in the 1984 AN or its predecessor ANs, come to grips with the problem of how to deal with these delinquent borrowers on a longer-term basis. While the AN made it clear that the Continuation Policy

established each year was to extend through that production year only, it did not establish, in advance, clear rules for dealing with borrowers whose financial situations did not improve, but got progressively worse.

Since a new law has been enacted affording FmHA borrowers substantial debt restructuring options, FmHA proposes to limit the making of Continuation Loans to only those borrowers who have not had the opportunity to be fully considered for these new options. Unlike the situation which existed in 1982–1985, FmHA now has a powerful statutory mechanism which it must use, at a borrower's request, in attempting to resolve the borrower's financial problems on a long term basis. If a borrower has encountered financial difficulties, caused by forces beyond his/her control, the Continuation Loan will be available to enable the borrower, if otherwise eligible, to operate for another year while his or her situation can be further evaluated and fully considered for debt restructuring/writedown. The borrower will also be able to seek administrative review of the restructuring decision from a new, independent, appellate body within the Agency. If the restructuring process results in written-down or defeated debt, the borrower will no longer be "delinquent" once the process has been completed; and the Continuation Loan would not be used, nor would it be necessary, since the borrower should be eligible for operating credit under normal terms.

If the borrower's financial situation is so serious that it cannot be resolved, even through the restructuring process, then under this proposal, FmHA would not extend another Continuation Loan once the restructuring process, including the administrative appeal, was completed. If the borrower did not qualify for restructuring/writedown, FmHA would then proceed to accelerate the borrower's account, including any outstanding Continuation Loan, immediately after the Continuation Loans came due. The FmHA would not consider the borrower for another Continuation Loan, as that would prevent all collection activities for another production year.

The FmHA realizes that the policies resulting from this proposed rule will, in many instances, cause the borrower to discontinue farming. However, FmHA has no reasonable alternative. Under the terms of the Continuation Loan policy presently in effect, a borrower is eligible for consideration of a Continuation Loan only if the FmHA loan(s) is delinquent and cannot be brought current through use of FmHA's various servicing options. These borrowers are specifically made eligible even though they cannot repay the installment(s) or the balance due on any other existing indebtedness, including debts owed to FmHA and to other providers of credit. Also, once a Continuation Loan has been made, FmHA is precluded from proceeding with acceleration and foreclosure until after the Continuation Loan comes due and the progress or further deterioration of the operation is known.

Under a purely mechanical application of the present rule, the borrower could, conceivably, receive a new Continuation Loan year after year even though the borrower had not made any payment on any other debt the preceding production year, including last year's Continuation Loan.

While this result was perhaps acceptable during the 1982–85 period, when the new section 353 loan restructuring authority did not exist, FmHA does not believe the Congress, in enacting the new Continuation Policy, intended to establish a back-door annual grant program, but rather intended the new law to be used to assist troubled borrowers during the period in which Congress could complete its consideration of the then-pending debt restructuring legislation. This consideration ultimately resulted, on January 6, 1988, in the enactment of the new restructuring authority. During the 1988 calendar year, this new authority will be implemented through regulations and used to resolve the situations of troubled borrowers on a more permanent basis.

As in the case of the element of this Notice dealing with eligibility for Continuation Loans, FmHA is not committed to the terms of this particular proposal. All comments and views on this extremely difficult question will be considered carefully, in an effort to construct a system which will effectuate the underlying Congressional purposes reflected in the Continuation Loan legislation and the Agricultural Credit Act provisions.

List of Subjects in 7 CFR Part 1941

Crops, Livestock, Loan programs—Agriculture, Rural areas, Youth.

Therefore, as proposed, Chapter XVIII, Title 7, Code of Federal Regulations, is amended as follows:

PART 1941—OPERATING LOANS

1. The authority citation for Part 1941 continues to read as follows:

Authority: 7 U.S.C. 1989; 5 U.S.C. 301; 7 CFR 2.23; 7 CFR 2.70.

Subpart A—Operating Loan Policies, Procedures and Authorizations

2. Amend introductory text of § 1941.14(a)(2) to read as follows:

§ 1941.14 Annual production loans to delinquent borrowers.

* * * * *

(a) * * *

(2) The borrower has been unable to pay accounts as scheduled. Examples of this would be:

* * * * *

3. Amend § 1941.14 by revising paragraph (a)(6) and adding new paragraph (a)(7) to read as follows:

§ 1941.14 Annual production Loans to delinquent borrowers.

* * * * *

(a) * * *

(6) Non-disturbance agreements will be obtained from other creditors, as necessary.

(7) FmHA has not completed the process (including any administrative appeal and further review) of considering the borrower for debt restructuring, pursuant to Subpart S of Part 1951 of this chapter.

* * * * *

Date: August 2, 1988.

Roland R. Vautrot,

Under Secretary for Small Community and Rural Development.

[FR Doc. 88–21900 Filed 9–23–88; 8:45 am]

BILLING CODE 3410–07–M

Senator BOREN. The next witness that we have today will be Mr. Lee Swenson, president of the National Farmers Union.

Mr. Swenson, if you would like to come forward.

Why don't we bring the rest of the witnesses up in a panel. I think that might be best. Mr. Benny Bunting, chair, credit committee of the National Save the Family Farm Coalition; and Mr. James T. Massey, executive director of the Farmers' Legal Action Group, Inc. of St. Paul, Minnesota.

We are glad to have all of you, and we can just go right down the row and have you make your opening statements before we commence our questions to you, and we would be happy to have you summarize. I think that it is always beneficial to just hit the high points for us and we will receive the full prepared statements for the record. I have often felt that since we can read the statements, it is easier for us and you can get the points that you really want to stress and just go ahead and summarize your statements for us.

We will begin with Mr. Swenson. We are happy to have you.

STATEMENT OF LELAND H. SWENSON, PRESIDENT, NATIONAL FARMERS UNION, WASHINGTON, DC

Mr. SWENSON. Thank you, Mr. Chairman. I appreciate the opportunity to be here today to express the views of our organizations on the Farmers Home Administration implementation of the Agricultural Credit Act.

I will attempt to summarize my statement after listening to much of the discussion, but the Farmers Home Administration recently issued interim final rules on borrowers' rights, and they appear to be right on target with the mandates of the act. We have some areas of disagreement, but by and large the rules demonstrate a concern over protecting Government interests with a genuine effort to treat the FmHA borrowers and former landowners fairly.

We commend the men and women who spent hundreds of hours drafting the rules and regulations and demonstrating the willingness to listen to the people.

Mr. Chairman, I was prepared to appear before you today full of hope for the future now that all three branches of Government seem basically in agreement as to the proper approach of handling in good faith the FmHA borrowers struck by drought, poor commodity prices, or other circumstances beyond their control.

Then I heard what has been mentioned here, Farmers Home Administrator Vance Clark's statement last week to the effect that his efforts to straighten out the agency had been thwarted by liberal congressional committee chairmen who were leading us down the path of socialism.

The Constitution of the United States states that Government is of the people, by the people and for the people and the Farmers Home Administration, to me, is part of that Government and that is not socialism.

As mentioned by Senator Harkin, agency representatives have said that Congress in passing the Agricultural Credit Act would cost honest taxpayers billions of dollars.

Mr. Chairman, I am sure that you and other members of this committee who worked so hard for so long on this Agricultural Credit Act are tired, as we are, of people who ought to know better claiming that this act is a ripoff of the American taxpayer. Before I address our specific concerns with implementing the act, I would like to take a few moments to set the record straight on a few facts surrounding this vital piece of legislation.

FACTS

Title XIII of the Food Security Act of 1985 gave FmHA considerable latitude in working with borrowers. Their failure to use much of that authority led to protracted and costly litigations through which borrowers have gradually won the right to be treated fairly, and FmHA has been forced to do what should have been done in the first place, and that is really a waste of taxpayers money.

According to a report issued on June 6, by the House Committee on Government Operations, House Report 100-725, FmHA's implementation of the Food Security Act revealed an inadequate management structure. The Inspector General found that 14 State directors had failed to follow FmHA instructions calling for periodic review of market conditions to avoid further depressing of land values with sales of inventory property. Mr. Chairman, fire sales of Government property are also a waste of taxpayers' money.

The act received unanimous votes in this subcommittee and the full committee and enjoyed an overwhelming majority on the Senate and House floors. It was because of your leadership, Mr. Chairman, that in building a bipartisan consensus that the National Farmers Union chose to honor you with the Golden Triangle Award. To suggest that any narrow interest group dominated the debate on this legislation is patently absurd.

By definition, debt restructuring is only required when it is the Government's least cost alternative. We do not call that socialism, Mr. Chairman. We call that common sense and I think you stated that already, and we commend you and Members of Congress for following that path.

Having said that——

Senator BOREN. You should not have to hurry. You can take all the time you would like in the course of your remarks. [Laughter.]

I appreciate it very much.

Mr. SWENSON. Having said all of that, I would like to return to specific areas of concern which the National Farmers Union has with the regulations implementing the Agricultural Credit Act.

ENFORCEMENT

Our first and most important concern is enforcement. No one expects legislation or regulations to result in an overnight change of attitudes. There are many positive changes from the proposed rules to the interim final rules on primary and preservation loan servicing. We must all remain vigilant in our oversight of this act's implementation.

LOANS TO ORGANIZATIONAL BORROWERS

We are concerned by the agency's determination that loans to organizational borrowers, such as Indian Land Acquisition loans and Grazing Association loans are not included in the FmHA's debt write-down or leaseback/buyback authority under the act.

FATE OF THE INTEREST RATE BUY-DOWN PROGRAM

We are concerned about the fate of the interest rate buy-down program as a restructuring tool. The House Committee on Government Operations report, which I have referred to earlier, charged that only a miniscule proportion of the program's available funds had been used when the program was more than half over. Since Congress has chosen to extend the program, we must renew our commitment to ensure that the program operates as Congress intended for the next 5 years.

VALUATION OF CONSERVATION EASEMENTS

We are concerned about the valuation of conservation easements used in debt restructuring. When buffer zones are added around the easements, fields become broken up and it can be difficult to reach the usable land with large equipment. We believe that the value attached to the easement for write-down purposes should not simply reflect the pro rata adjustment based on the size of the easement. It should also reflect any diminished value of the remaining acreage.

Senator BOREN. Do the regulations speak to that specifically or is that a matter that under the regulations the administrative process is to attach value? I agree with what you just said about being more than a pro rata share. Do the regulations say pro rata share only? Or do they allow full value?

Mr. SWENSON. I believe it is on a pro rata share of the easement.

Senator BOREN. The regulations themselves? So they do not take into account whether or not that is in breaking up a parcel of land.

Mr. SWENSON. Yes, or the buffer zone that is put around it.

Senator BOREN. That is something I think we ought to express our concern about because I agree with the statement you just made, yes.

TAX CONSEQUENCES OF THE AGRICULTURAL CREDIT ACT

Mr. SWENSON. And finally, we are deeply concerned with the tax consequences of the Agricultural Credit Act. Debt restructuring under the act means very little to a borrower who ends up liquidating the farm in order to pay the Internal Revenue Service.

So, Mr. Chairman, the Agricultural Credit Act of 1987 represents hope for nearly every person interested in agricultural credit, whether he is a Farm Credit System lender, a rural banker interested in long term farm lending, a current borrower concerned with the value of his Farm Credit System stock, or a financially troubled borrower trying to work his way out of a bad situation not of his own making. FmHA has made a positive step forward with its interim final rules on borrowers' rights. We look forward to working with you and the rest of this subcommittee to ensure that

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the Government can keep its costs down while still treating farmers and ranchers with fairness and dignity.

Thank you for the opportunity to express our concerns. I will be happy to answer any questions.

Senator BOREN. Thank you very much, Mr. Swenson. Really my only question was a follow-up to your comments and I will make an expression as chairman of the subcommittee to the Farmers Home Administration on the matter that you raised on the conservation easements. We will do that and I assure you we intend to be very, very diligent in the oversight of the implementation because I think overall, as you said, we have a good act, with some few changes that need to be made, and the regulations appear to be moving in the right direction now. The critical question is will they really be implemented aggressively and the spirit of them carried out, and I assure you this subcommittee, as you can tell from the comments made this morning, will be aggressively making sure that that is done. We appreciate you being here.

Mr. SWENSON. Thank you.

Senator BOREN. Mr. Bunting.

[The prepared statement of Mr. Swenson follows:]

TESTIMONY OF LELAND H. SWENSON, PRESIDENT, NATIONAL FARMERS UNION BEFORE THE SUBCOMMITTEE ON AGRICULTURAL CREDIT, SENATE COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY, SEPTEMBER 30, 1988

Thank you Mr. Chairman, and good morning. My name is Leland Swenson, and I am the President of the National Farmers Union. I appreciate the opportunity to be here today to express the views of our organization on the Farmers Home Administration's (FmHA) implementation of the Agricultural Credit Act of 1987 (Act).

I must begin by confessing that I was surprised and heartened when my staff reported to me that the FmHA's recently issued interim final rules on borrowers rights appeared to be right on target with the mandates of the Act. We have some areas of disagreement, but by and large the rules demonstrate a concern over protecting government interests with a genuine effort to treat FmHA borrowers and former landowners fairly. Rules on debt restructuring reflect Congressional intentions that the government's lender of last resort end its past practice of "foreclose first and ask questions later." The rules seem to indicate a new attitude which recognizes that working with a borrower through a period of financial hardship can often be the cheapest and least painful route for everyone. Yes, Mr. Chairman, I was prepared to appear before you today full of hope for the future now that all three branches of government seem basically in agreement on the proper approach for handling good faith FmHA borrowers struck by drought, poor commodity prices, or other circumstances beyond their control.

Then I heard of FmHA Administrator Vance Clark's statement last Wednesday to the effect that his efforts to straighten out the agency had been thwarted by liberal Congressional Committee Chairmen who were leading us down the path to socialism. Mr. Clark seemed to think that Congress, by passing the Agricultural Credit Act, would cost honest taxpayers billions of dollars. That's when I came back to the reality that we're dealing with an agency representing an Administration that would not only like to do away with Farmers Home Administration programs, but advocates the complete dismantling of farm programs by the year 2000.

Mr. Chairman, I'm sure that you and the other Members of this Committee who worked so hard for so long on the Agricultural Credit Act are as tired as we are of people who ought to know better claiming that this Act is a rip-off of the American taxpayer. Before I address our specific concerns with implementing the Act, I would like to take a moment to set the record straight on the facts surrounding this vital piece of legislation.

Fact #1: Title XIII of the Food Security Act of 1985 gave FmHA considerable latitude in working with borrowers. The agency was authorized to adjust debt, to accept payments from the lease of mineral rights, to use soft timber loans and conservation easements in helping borrowers through financial

difficulties, and to set up an interest rate reduction program for guaranteed loans. FmHA's failure to use much of this authority, except for occasional use of debt settlement after foreclosure, led to protracted, costly litigation through which borrowers have gradually won the right to be treated fairly and FmHA has been forced to do what it should have done in the first place. Now, that's a waste of taxpayers' money.

Fact #2: According to a report issued in June by the House Committee on Government Operations (House Report 100-725), FmHA's implementation of the Food Security Act revealed an inadequate management structure. An entire section of that report is devoted to the agency's violation of a statutory prohibition against selling inventory land into an already-depressed market. The Inspector General found that fourteen State Directors had failed to follow FmHA instructions calling for periodic review of market conditions to avoid further depressing land values with sales of inventory property. Mr. Chairman, firesales of government property are also a waste of taxpayers' money.

Fact #3: It was FmHA's track record on the Food Security Act that convinced many Members of Congress to include the agency in a bill that began as rescue legislation for the Farm Credit System. Much of the impetus for providing the right of first refusal to prior owners when inventory land is sold came from a belief that FmHA had not dealt fairly with its former borrowers who had lost their farms.

Fact #4: FmHA itself had more to do with the final language of the Act than just about anyone else. In both the House and Senate, advocates for farmers stood out in the hallway while FmHA negotiated in private with members. Mr. Eric Thor earned such a reputation as an effective watchdog of the government's interests that he was quickly selected to be the Executive Director of the new Farm Credit System Assistance Board.

Fact #5: The Act received unanimous votes in this subcommittee and in the full committee, received only two negative votes in the House Committee on Agriculture and enjoyed an overwhelming majority on the Senate and House floors. It was because of your leadership in building a bi-partisan consensus that the National Farmers Union chose to honor you with our Golden Triangle Award, Mr. Chairman. To suggest that any narrow interest group dominated the debate on this legislation is patently absurd.

Fact #6: By definition, debt restructuring is only required when it is the government's least cost alternative. If FmHA estimates that it will cost X to restructure eligible borrowers, then we know that foreclosing on good faith borrowers who fell behind on their loans, due to circumstances beyond their control, would cost taxpayers more than X. This is not a give-away program to farmers who simply decided not to pay their debts. It is a program designed to cut the government's losses by receiving some payment from borrowers who, through no fault of their own, are unable to meet their original payment schedule. Granted,

restructuring will require the government to recognize whatever loss it will take sooner than if a foreclosure proceeding were allowed to run its course, but the bottom line is that debt restructuring will save the government money. We don't call that socialism, Mr. Chairman; we call it common sense. And we commend you and other Members of Congress who insisted that the agency follow this path.

Having said all of that, I would like to return to specific areas of concern which the National Farmers Union has with regulations implementing the Agricultural Credit Act.

Our first and most important concern is enforcement. Despite the fact that the Act became law on January 6, we have gotten numerous reports from our members that their local FmHA office would not begin restructuring until regulations were in place. We understand that training on the interim final rules has already begun, for which we are grateful, but every effort must be made to ensure that the rules are understood and followed by FmHA staff. No one expects legislation or regulations to result in an overnight change of attitudes. There are many positive changes from the proposed rules to the interim final rules on primary and preservation loan servicing. We must all remain vigilant in our oversight of the Act's implementation.

Second, we are concerned by the agency's determination that loans to organizational borrowers, such as Indian Land Acquisition loans and Grazing Association loans are not included in FmHA's debt write-down or leaseback/buyback authority under the Act. FmHA provides no justification for this position. We can only assume that FmHA infers from the fact that Native Americans were specifically included in provisions for the right of first refusal, that they must be excluded from other borrowers' rights where no specific mention is made. We disagree with this interpretation. We doubt that Congress intended to preclude FmHA's use of write-down when it is the agency's least cost alternative for dealing with an Indian Land Acquisition loan.

Third, we have some concerns with the final rules on adverse decisions and administrative appeals issued on July 12. Glad that they've decided to let appellants get transcripts of the proceedings and that the use of conference calls is basically at the borrower's option. But, we're still very concerned about the lack of training for the hearing officers. No one's asking these people to be ex-Supreme Court Justices, but they are supposed to approximate Administrative Law Judges. They should have a fairly good understanding of rules of procedure and evidence to ensure that both sides of the issue receive a fair hearing. The final rules provide a one-page "Guide" to Conducting a Hearing." We don't think that's enough -- particularly now that we're getting reports from our members that county supervisors are being recruited to fill appeals positions. While there is some logic in using people already familiar with FmHA regulations to get the process up and running, for many people the idea of one county supervisor's decision being reviewed by another ex-county supervisor is hardly a model of a fair and impartial appeals process.

Fourth, we have a very similar concern with the final rules

on certified mediation programs, which were published on August 26. One of the criteria which a state program must meet to be certified to receive federal matching funds is that it provide for the training of mediators. FmHA should have provided some additional guidance on the form of that training to assure a minimum standard of competence before taxpayers' funds are invested. Mediators must have a working understanding of Act, and the rules and regulations for federal lenders such as FmHA, Farm Credit System institutions, the new Federal Agricultural Mortgage Corporation, and even the Small Business Administration. They must understand state laws governing debtor/creditor relationships, including mediation, homestead protection, redemption, etc. To be in control of the mediation proceeding, mediators should know something about basic rules of procedure and evidence. To know if a proposed restructuring plan would work better than bankruptcy reorganization or liquidation, mediators should be familiar with the bankruptcy code and potential tax consequences. In short, mediating agricultural debt is an extremely complex process, and the public has a right to expect that matching funds will go into programs in which mediators have been given the tools to do their jobs properly.

Fifth, we are disturbed by the apparent lack of progress in getting the joint Farm Credit System/FmHA demonstration project off the ground. As you recall, that project provided some interest rate relief through FmHA by which eligible borrowers could purchase Farm Credit System inventory land in those districts certified to receive financial assistance. A memorandum of understanding between the Farm Credit Administration and FmHA was signed on March 3, and several Farm Credit districts have been certified. Yet, to our knowledge, no one has been able to participate in this program nearly seven months later.

Sixth, we are concerned about the fate of the interest rate buydown program as a restructuring tool. The House Committee on Government Operations report to which I referred earlier charged that with fifty-eight percent of the program's original term elapsed, only six percent of the available funds had been obligated. And, many of the case files reviewed by the Inspector General revealed major errors in implementing the program. Under the Food Security Act, the Interest Rate Reduction program would have expired today, Mr. Chairman. Since Congress has chosen to extend the program, we must renew our commitment to ensure that the program operates as Congress intended for the next five years.

Seventh, we are concerned about the valuation of conservation easements used in debt restructuring. The types of land that qualify for these easements don't follow neatly drawn lines. The land may contain a meandering stream, or a wet spot in the middle of an otherwise productive field. When buffer zones are added around the easement, fields become broken up and it can be difficult to reach the usable land with large equipment. We believe that the value attached to the easement for write-down purposes should not simply reflect a pro-rata adjustment based on the size of the easement. It should also reflect any diminished value of the remaining acreage.

Finally, as a more general matter, we are deeply concerned

with the tax consequences of the Agricultural Credit Act -- both for Farm Credit System lenders and for all agricultural borrowers. Debt restructuring under the Act means very little to a borrower who ends up liquidating the farm in order to pay the Internal Revenue Service. The Act clearly demonstrated Congressional interest in working with farmers to keep them on their farms. To truly fulfill this goal, we must address tax provisions dealing with capital gains, investment tax credit recapture, debt forgiveness and bankruptcy. We commend Senator Conrad for his interest in this issue, and pledge him our support in resolving these matters as quickly as possible.

Mr. Chairman, the Agricultural Credit Act of 1987 represents hope for nearly every person interested in agricultural credit, whether he is a Farm Credit System lender, a rural banker interested in long-term farm lending, a current borrower concerned about the value of his Farm Credit System stock, or a financially troubled borrower trying to work his way out of a bad situation not of his making. FmHA has made a positive step forward with its interim final rules on borrowers' rights. We look forward to working with you and the rest of this subcommittee to ensure that government can keep its costs down while still treating farmers and ranchers with fairness and dignity.

Thank you for this opportunity to express our concerns. I would be happy to address any questions you might have.

STATEMENT OF BENNY BUNTING, CHAIR, CREDIT COMMITTEE, NATIONAL SAVE THE FAMILY FARM COALITION, OAK CITY, NC

Mr. BUNTING. Senator Boren, speaking for farmers across the country, I would certainly like to express our gratitude for your diligent work on the Agricultural Credit Act of 1987. It has the potential for strengthening the family farm structure with fairness and dignity for both the farmer and lender. We are here today with guarded optimism because we are acutely aware of past favorable legislation that has been degraded to symbolism when implemented by the Farmers Home Administration.

Within days of the publication of the interim final regulations in the Federal Register, which have given us an opportunity to see major positive changes from the proposed regulations, Vance Clark said, "the $2 billion that the agency will lose this year is the result of liberal legislators pushing the agency towards socialism. FmHA collection efforts have caved in to special interests and the portfolio is very stressed with $7.3 billion in delinquent loans." With a positive attitude, much can be accomplished, but with negativism, many of these farmers are destined to the same abusive policy implementation as always.

These attitudes are not new. For 10 years FmHA has taken actions which required litigation to force them to comply with the law. In February 1988, FmHA burned down a homestead in North Dakota, claiming that they hadn't yet seen the new legislation. In April, months after the enactment of the Agricultural Credit Act, but before publication of the proposed regulations, Vance Clark presented figures to the Senate Agriculture Appropriations Subcommittee that predicted a very low percentage of farmers eligible for debt restructuring and a very high price tag. This painted a very unfair picture to the public about the entire Agricultural Credit Act. A write-down is only an option when it is the least cost alternative to the Federal Government.

The future for many of the 118,000 family farmers that will be receiving notices about their options under the Agricultural Credit Act is bleak if the numbers furnished to the Senate Appropriations Committee reflect the clear intent of the FmHA. We have been following the implementation of the Agricultural Credit Act and our member groups have submitted hundreds of comments on the proposed regulations. We also met with Vance Clark in mid-April to express our concerns about the ongoing implementation of the act. I have attached a copy of his response to our letter to my testimony.

Senator BOREN. We will receive that.

Mr. BUNTING. The concerns I present today are on behalf of the Credit Committee of the 43 member groups of the National Save the Family Farm Coalition representing farmers in 35 States. Our concerns focus on three major areas.

First, the implementation of the Agricultural Credit Act, both where final regulations have already been implemented and with regard to actions that FmHA was to take upon enactment that did not require regulations.

Second, our concerns with the interim final debt restructuring regulations published on September 14.

Third, our proposal for a credit forbearance policy for both FmHA and Farm Credit Administration to implement the credit provisions of the Disaster Assistance Act of 1988.

AGRICULTURAL CREDIT ACT IMPLEMENTATION

LAND IN FMHA INVENTORY

Land was being sold out of FmHA inventory despite the enactment of the Agricultural Credit Act on January 6, 1988, until Representative Walter Jones of North Carolina intervened. The result was the issuance of a nationwide Administrative Notice halting all sales unless they were to the previous owner or pending contracts. There has been, however, 1,480 sales of FmHA inventory land since January 14 and we question who has been buying this land. These sale levels are 25 percent higher than last year when there was no freeze on land sales. A major question is whether all the land has been reclassified as surplus or suitable and, if so, why out of 1,913 sales this year, 1,074 were designated as suitable and 738 were surplus. A further question is whether once the previous owner has been reached and is interested in the land, can a lease to a third party be executed? And this is still happening now and I can cite the exact examples of this going on.

RELEASE OF INCOME

A major provision of the Agricultural Credit Act was the immediate release of essential living and operating expenses for those accelerated borrowers covered under the *Coleman* case. Despite being set at an unrealistically low level of $18,000, even this amount was not received by many eligible farmers this past spring. Part of the problem was that the initial notices sent out to the farmers were very confusing and had misleading information about definition of those actively engaged in farming. Only after pressure from farm groups did FmHA send clarifying information to the County Supervisors that had a broader definition of "actively engaged in farming," but this was after the deadline for application.

COUNTY COMMITTEE ELECTIONS

Despite many public comments on the proposed regulations, very few policy changes were incorporated into the final regulations. A major concern of our member groups is the role of the appointed FmHA eligible borrowers in contrast to the elected FmHA eligible borrowers. We strongly urge FmHA to issue regulations that would state that FmHA eligible borrowers democratically elected by fellow farmer/borrowers should have priority in representing his or her area over a member appointed by the State FmHA director. This is particularly important since the law states that there can be only one FmHA eligible borrower on the County Committee. We fear that they will be appointing their picked borrowers who then would negate farmers being able to elect borrowers for 3 years, and that was a problem.

APPEALS PROCESS

Mr. Clark talked about the appeals process in the hiring of the new officers. That has been a problem because in the past, only 1 to 3 percent reversal rate was averaged in the appeals process. But what is going to change if they still have in-house hired help? I think Mr. Clark said 50 percent of them were in-house. Is that 1 to 3 percent reversal rate going to change? We have some concerns about it being an independent process.

TARGETED FUNDS FOR SOCIALLY DISADVANTAGED INDIVIDUALS

This section of the law was implemented in August 1988 but the final date for the application is today, September 30. This was a very short period of time for this process. Many that have applied have been turned down. But one suggestion we would like to make is that those who have applied, and their application is still in the process, that it be allocated in the 1988 fiscal year. It seems to be a problem, just August to September 30.

Concerns With FmHA Debt Restructuring Regulations

APPLICATION FOR HOMESTEAD

There is a new requirement for a photo of the homestead. This seems to be in small print and could be a problem if you are using the ASCS photos which will not show the complete homestead if it is an old photo. We want to make sure that this is not a problem that will limit or forgo the application.

AUTHORITY FOR APPROVING DEBT RESTRUCTURING

The regulations state that County Supervisors cannot approve reamortization or rescheduling more than once. That seems to be a problem we would like to be addressed.

SHARED APPRECIATION AGREEMENT

We have major concerns on the effect of shared appreciation agreement on farmers at the end of the 10-year period. The interim final regulations state the recaptured amount will be added on to the principle of the note and the note will be reamortized over the remaining life of the loan. That could be a tremendous problem if the remaining life of the loan is a few years and you have a tremendous debt. There is no way there is going to be any cash-flow over a small amount of time. We think it should be that you can get a separate loan. This would be at least so that you could get a separate loan extended out over a longer period of time at the current interest rate.

GOOD-FAITH REQUIREMENT

We have a problem with that in that it says, "Agreement for the Use of Proceeds/Release of Chattel Security: and agreements made with FmHA." We think that should say—we urge that to say "written agreements." You know, we do not want to come up on a one-sided deal where they just say you did not follow this so you

did not have good faith. We want it to say that it was written agreements.

TAX IMPLICATIONS

To us that looks like it is going to be a drastic issue, especially with the shared appreciation agreements, but even as well as with people that in the past have been liquidated and are off the farm and made applications for debt settlement. I can tell you, the Krafts in North Carolina made application for debt settlement 3 years ago. It was approved on the county level by the County Committee and sent to the State director. It was disapproved and has had no response on the second approach that was made. But under the tax laws now, Mr. Kraft is no longer a farmer. He has not been a farmer in the former year of the tax writeoff. If the director now was to write that debt off with debt settlement, he would be responsible for that amount of money as income. Who should be responsible for that tax debt? It should not be he who made the application. Actually, the State director should be responsible for that tax liability. That is not an isolated problem.

Senator BOREN. Well, I know exactly the problem you are talking about. In fact, I succeeded a couple of years ago in getting a generic proposal in the Senate Finance Committee talking about the debt forgiveness restructuring and so on, that was carried out through a Government-sponsored program so that a Government write-down would not be counted as taxable income to the person going through restructuring.

We passed that in the Senate Finance Committee and I believe we passed it on the Senate floor as well, but then the language in conference was changed. It appears there is a really pressing need to go back in on the tax side and clear this up so that the IRS will not be going after these people. So I will put on my other hat as a member of the Senate Finance Committee. I chair the Agricultural Tax Subcommittee over in the Finance Committee, which would be the subcommittee over in the Finance Committee that has jurisdiction on the tax side of it.

We will make contact with the IRS about this matter. We will find out exactly if there are additional changes in the statute that need to be made and if there are, early next year I will make that the first order of business on that subcommittee over there to try to get these changes made because I know exactly what you are taking about. I know we passed it and I lost track, to some degree, of what happened. It went through a conference committee then went to the House and the Senate and it could have been that the original language that I wrote was changed in a way that the IRS is interpreting it now as not covering the situation.

But we will go back into that and we will schedule hearings on that matter and we will try to make sure that if the IRS will not grant administrative relief, that we will come in and rewrite the statute to make that clear, because I think that is an important point.

Mr. BUNTING. And grandfather it in?

Senator BOREN. Absolutely, yes.

Mr. BUNTING. That is good. And we see it as a problem also. It needs to be addressed even in chapter 12. When you bring your basis down to zero, at some point in time you are still going to have recapture of that tax liability and it is bad because if it transfers to the kids and they sell it, it has got to be recaptured.

Senator BOREN. That is right. I understand what you are saying. We will go back into that, I assure you, and in the other committee we will look at that early next year, if we cannot get it resolved administratively.

Mr. BUNTING. I know I have got to rush now.

DISASTER ASSISTANCE ACT CREDIT FORBEARANCE

You know and we know that the Agricultural Credit Act and the Disaster Assistance Act disaster payments alone will fall short of keeping farmers on the land. This is especially true if they are already in a serious credit crunch before this devastating drought. So, what we would like is, Members of Congress to work to ensure that the Farmers Home Administration and the Farm Credit System publish a clearly written forbearance policy that is widely distributed to the farmer/borrowers. We have a policy in the record that we would like to use as a format for that.

CONCLUSION

In conclusion, declining farm prices and competent litigation in the *Coleman* case were fair warnings of a developing crisis in agriculture. Congress responded with wisdom, foresight, and legislation to protect the family farm structure and stabilize rural communities to ensure food security for the Nation. We hope the USDA will heed the directive given by the *Coleman* court and the Congress and justly implement the Agricultural Credit Act of 1987.

Thank you for your consideration of our views.

Senator BOREN. Thank you very much, Mr. Bunting. You have given us some very excellent suggestions here for some specific changes in the regulations. I have noted your point on the County Committees, several points you made on the appeals process and others we have discussed as we have gone along. Mr. Swenson raised a good point on this conservation easement and some other things that need to be changed in the final regulations. What we will endeavor to do is circulate a letter where we can get a broad consensus from the subcommittee back to the Administrator urging that these changes be made in the final regulations, and I appreciate the good suggestions, the very specific suggestions that you have brought to us in your statement.

Mr. BUNTING. I have a question that I would like to get answered. It is a specific case on lease-backs. When people have applied—former owners and new people on the priority list—I thought there was a process of not making any more longer-term leases, and I know that is not the case because I know of cases.

Senator BOREN. People are getting longer-term leases?

Mr. BUNTING. A third party is getting a start-up long-term lease when the former owner has applied for the lease-back, and the Farmers Home is saying, we will entertain your application at a period of time 6 months off.

Senator BOREN. It should not be. I mean, that is certainly contrary to the spirit of what we thought we were legislating.

Mr. BUNTING. Well, that is what we have been reading and it is continuing.

Senator BOREN. Well, we will include that in our inquiry, too, and if you can provide staff with some examples of that it would be helpful to us.

Mr. BUNTING. OK.

Senator BOREN. Cases where you know that that has happened. But in my opinion, I thought we were legislating against that.

Mr. BUNTING. That is what we thought.

Senator BOREN. I think that is a violation of the law. If they are going on they should be stopped and we will make sure of that. I think we will make sure the Administrator shares the same interpretation of the law as we do. Is there someone here from Farmers Home?

[No response.]

Senator BOREN. We will make sure that that is right. OK. We will follow through with that. If we need to make an amendment to the law we will, but I think that clearly is the intent of the law.

Mr. Massey.

[The prepared statement, with attachments, of Mr. Bunting follow:]

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STATEMENT OF BENNY BUNTING, CHAIR - CREDIT COMMITTEE, NATIONAL SAVE THE FAMILY FARM COALITION BEFORE THE SENATE AGRICULTURE CREDIT SUBCOMMITTEE. --- September 30, 1988

Senator Boren. Speaking for farmers across the country, I would certainly like to express our gratitude for your diligent work on the Agricultural Credit Act of 1987. It has the potential for strengthening the family farm structure with fairness and dignity for both the farmer and lender. We are here today with guarded optimism because we are acutely aware of past favorable legislation that has been degraded to symbolism when implemented by the Farmers Home Administration.

Within days of the publication of the interim final regulations in the Federal Register which have given us an opportunity to see major positive changes from the proposed regulations, Vance Clark said, "the $2 billion that the agency will lose this year is the result of liberal legislators pushing the Agency towards socialism. FmHA collection efforts have caved into special interests and the portfolio is very stressed with $7.3 billion in delinquent loans." With a positive attitude, much can be accomplished but with negativism, many of these farmers are destined to the same abusive policy implementation as always.

These attitudes are not new. For ten years FmHA has taken actions which required litigation to force them to comply with the law. In February 1988, FmHA burned down a homestead in North Dakota claiming that they hadn't yet seen the new legislation. In April, months after the enactment of the Ag Credit Act but before publication of the proposed regulations, Vance Clark presented figures to the Senate Agriculture Appropriations Committee that predicted a very low percentage of farmers eligible for debt restructuring and a very high price tag. This painted a very unfair picture to the public about the entire Agricultural Credit Act. A write-down is only an option when it is the least cost alternative to the federal government.

The future for many of the 118,000 family farmers that will be receiving notices about their options under the Agricultural Credit Act is bleak if the numbers furnished to the Senate Appropriations Committee reflect the clear intent of the FmHA. We have been following the implementation of the Agricultural Credit Act and our member groups have submitted hundreds of comments on the proposed regulations. We also met with Vance Clark in mid-April to express our concerns about the ongoing implementation of the Act. I have attached a copy of his response to our letter to my testimony.

The concerns I present today are on behalf of the Credit Committee of the 43 member National Save the Family Farm Coalition representing farmers in 35 states. Our concerns focus on three major areas:

First, the implementation of the Agricultural Credit Act both where final regulations have already been implemented and with regard to actions that FmHA was to take upon enactment that did not require regulations.

Second, our concerns with the interim final debt restructuring regulations published on September 14th.

Third, our proposal for a Credit Forebearance policy for both FmHA and FCA to implement the credit provisions of the Disaster Assistance Act of 1988.

AGRICULTURAL CREDIT ACT IMPLEMENTATION:

Land in FmHA Inventory: Land was being sold out of FmHA inventory despite the enactment of the Agricultural Credit Act on January 6, 1988 until Representative Walter Jones (D-NC) intervened. The result was the issuance of a nationwide Administrative Notice halting all sales unless they were to the previous owner or pending contracts. There have been however, 1,480 sales of FmHA inventory land since January 14th and we question who has been buying this land. These sale levels are 25% higher than last year when there was no freeze on land sales. A major question is whether all the land has been reclassified as "surplus" or "suitable" and if so, why out of the 1,913 sales this year, 1,074 were designated as suitable and 738 as surplus. A further question is whether once the previous owner has been reached and is interested in their land, can a lease to a third party be executed?

Release of Income: A major provision of the Agricultural Credit Act was the immediate release of essential living and operating expenses for those accelerated borrowers covered under the Coleman case. Despite being set at the unrealistically low level of $18,000, even this amount was not received by many eligible farmers this past spring. Part of the problem was that the initial notices sent out to farmers were very confusing and had misleading information about the definition of those "actively engaged in farming." Only after pressure from farm groups did FmHA send clarifying information to the County Supervisors that had a broader definition of "actively engaged in farming" but this was after the deadline for application.

County Committee Elections: Despite many public comments on the proposed regulations, very few policy changes were incorporated into the final regulations. A major concern of our member groups is the role of the appointed FmHA eligible borrowers in contrast to elected FmHA eligible borrowers. We strongly urged FmHA to

issue regulations that would state that FmHA eligible borrowers democratically elected by fellow farmer/borrowers should have priority in representing his/her area over a member appointed by the State FmHA Director. This is particularly important since the law states that there can be only one FmHA eligible borrower on the County Committee.

Since the initial County Committee elections in June, there have been numerous instances of voting irregularities resulting in new elections being scheduled in some areas. One re-scheduled election is underway today in Indiana with another election to be held in Iowa in mid-October. In Missouri there were formal complaints filed with the FmHA State Director due to nomination problems yet no action has been taken. Problems range from nominations not appearing on ballots, ballot-stuffing, active campaigning by FmHA officials, and advertisements appearing in local newspapers that totally disregarded that FmHA borrowers could run for County Committee positions. The reported incidents are probably reflective of many more abuses and an attitude of trying to ignore provisions in the Agricultural Credit Act that provide new roles for County Committee members and opportunities for participation. I have attached a copy of recent newspaper articles from both Indiana and Iowa on this issue.

Appeals Process: The need for reform in FmHA appeals was a priority issue of the Coalition during the debate on the Agricultural Credit Act of 1987. The final FmHA appeals regulations did reflect some of our comments to the proposed regulations. Most important was the removal of the option for a conference call appeal hearing at the discretion of the hearing officer. It is unclear to us how many appeals officers have been hired so far and whether they are in fact "independent." In the Southeast region, 9 of the 22 appeals officers hired so far are former FmHA employees.

Mediation Programs: Participation by FmHA in state mediation programs is very important to the success of mediation in our efforts to save family farms and ensure that the least cost alternative is reached. Recent regulations covering both the separate FmHA mediation regulations and the FmHA debt restructuring regulations stated that FmHA does not have to participate if the program is a voluntary mediation program - even in the 14 certified programs that will be receiving federal matching funds.

Targetted Funds for Socially Disadvantaged Individuals: This section of the law was not implemented until August 1988 for funds that must be disbursed before the end of the fiscal year which is today. This was very short notice for both notification about the program and for completing applications. There have also been reports that of those people applying, many have not been approved. We would request that pending applications be allowed to be considered under the FY 1988 allocated funds.

CONCERNS WITH FMHA DEBT RESTRUCTURING REGULATIONS:

The interim final regulations published on September 14th reflect many of the changes to the proposed regulations that were suggested by farm groups around the country to comply with the Agricultural Credit Act of 1987. Of the 247 comments received by FmHA, many of them came from borrowers who have been struggling with FmHA during the past seven years and see the proper implementation of the Agricultural Credit Act as the only way to receive a fair chance to stay on their farms and in their rural communities. The proposed regulations were a slap in the face to all who worked so hard to see strong FmHA provisions in the new law. The need for public involvement in the comment process is reflected in the changes that were made that will hopefully be implemented on the local level.

As a farmer involved in the Credit fight for many years, I have had the opportunity to read these regulations and see the changes in these final regulations. I only hope that every farmer going to their local FmHA office will receive the benefit of these new provisions and not have to wage a fight to get what is due to them under this important legislation. In reviewing the regulations we would like to present some of our concerns:

Application for Homestead: There is a new requirement for a photo of the homestead and 10 acres from ASCS to be submitted with an application for homestead within the 45 day timeframe. One concern is that this requirement is in fine print in a 7 page application and could be overlooked possibly causing the whole application to be rejected. The cost and accuracy of the photo is another concern.

Authority for Approving Debt Restructuring: The regulations state that County Supervisors cannot approve reamortization or rescheduling more than once. This would mean more red-tape or bureaucratic hassles facing a farmer who needs to be reconsidered.

Access to Computer Program: The entire debt restructuring calculations are on a computer program which is not DOS compatible. This means that borrowers cannot work through alternative cash-flows, understand the basis of a decision since the information is only accessible by computer.

Shared Appreciation Agreement: We have major concerns on the effect of a shared appreciation agreement on farmers at the end of the 10 year period. The interim final regulations state that "the recaptured amount will be added on the principal of the note and the note will be reamortized over the remaining life of the

loans at the applicable rate of interest. " We are concerned as to the role of FmHA in financing the recaptured amount. It appears that they will only reamortize the entire loan for the remaining life of the loan which could jeopardize the cashflow of the farming operation. Allowing a farmer to borrower at the current interest rate for the amount of the recapture would seem more reasonable. Furthermore, we have concerns over the role of the County Committee in making this critical determination.

Good-Faith Requirement: While the definition of "good-faith" was modified significantly since the proposed regulations, we still are concerned with language in (c)(2). This language states, "the borrower has acted in good faith by demonstrating sincerity and honesty in meeting agreements set forth on Form FmHA 1962-1, Agreement for the Use of Proceeds/Release of Chattel Security: and agreements made with FmHA." We would urge that these be written agreements.

Tax Implications: An overall concern of the Coalition are the tax implications of both current FmHA practices relating to debt settlement and the future problems relating to the provisions of the Agricultural Credit Act. While we recognize that this must be dealt with by the Finance Committee and affects the Tax Code, we are concerned that debt restructuring may not provide the necessary relief to farmers and be a viable alternative to Chapter 12 bankruptcy if there is no clarity on the future tax implications for farmers. We have concerns about Shared Appreciation Agreements and whether the debt write-down in 1989 s considered income or whether it is on hold until the year 2000. Today we are seeing FmHA delays in debt settlement resulting in farmers no longer meeting the "farmer exemption" since they have been forced to move to off-farm jobs for survival and are now facing major IRS tax assessments and fines. This is an issue that must be addressed if the intent of helping farmers remain in their rural communities is met.

DISASTER ASSISTANCE ACT CREDIT FOREBEARANCE:

The regulations to implement the Disaster Assistance Act of 1988 as of now do not include a definition for the credit provisions of the Act. We submit this definition as a neccessary step to ensure that farmer/borrowers are able to stay on their farms and benefit from both the implementation of the Agricultural Credit Act and the Disaster Assistance Act. Disaster payments will fall short of keeping farmers on their land, especially if they were already in a serious credit crunch before this devastating drought.

We propose that Members of Congress work to ensure that the Farmers Home Administration and the Farm Credit Administration publish a clearly written forebearance policy that is widely distributed to farmer/borrowers.

The Forebearance Policy should state:

1. A deferral of ownership and operating loan payments due FmHA and FCS institutions that are unable to be made in whole or in part due to the drought, with the portion of the payment put at the end of the loan without penalty or additional interest.

2. For the Farm Credit System, a halt to all foreclosures in all districts until FCA writes consistent, clear rules on debt restructuring and borrowers' rights; and until November 1, 1989.

3. A continuation of FmHA's current moratorium on foreclosures pending the proper implementation of the interim final regulations.

4. For FmHA, no administrative offsets of any drought payment, crop insurance payment or other drought-related payment, so that producers receive their payments directly.

5. For any farmer or rancher who can demonstrate a loss due to the drought and cannot make full or partial payments to FmHA and FCS, a waiver be granted to provide release of production income to cover items including but not limited to the following: taxes, basic living expenses-food, clothing, housing, medical and utilities, feed for livestock, fuel to maintain farm operation and harvesting, fixed educational fees before any production income is applied to loan payments or any amount is withheld from disaster payment checks.

Conclusion

Declining farm prices and competent litigation in the Coleman case were fair warning of a developing crisis in Agriculture. Congress responded with wisdom, foresight, and legislation to protect the family farm structure and stabilize rural communities to ensure food security for the nation. We hope the USDA will heed the directive given by the Coleman court and the Congress and justly implement the Agricultural Credit Act of 1987. Thank you for the consideration of our views.

A letter dated June 27, 1988, from Vance L. Clark, Administrator, Farmers Home Administration and newspaper articles follow:

United States Department of Agriculture
Farmers Home Administration
Washington D.C. 20250

JUN 2 7 1988

Mr. Benny Bunting
President
National Save the Family
Farm Coalition
80 F Street, N.W.
Suite 714
Washington, D.C. 20001

Dear Mr. Bunting:

This is in response to your letter of May 24, 1988, regarding the Agricultural Credit Act of 1987 which is being implemented through the formal regulations process.

Our response to the issues you have raised are as follows in accordance with the respective paragraphs of your letter.

Paragraph 3: "We realize that most of the provisions in the Agricultural Credit Act of 1987 do not go into effect until the regulations are finalized. It is our understanding, however, that FmHA should continue to act on applications by former owners for the lease/back-buy-back option in the Agricultural Credit Act of 1987. We have heard reports that local offices have been telling borrowers that any action on their applications must await final regulations. We urge you to restate the FmHA national policy so that there is no delay for farmers in their options to buy back or lease back their farms and continue farming."

Response: In January 1988, we advised all field offices that the sale and leasing of inventory property is suspended, except to the former owner until the new regulations implementing the Agricultural Credit Act of 1987 were published. We are continuing with the approval of leasing and selling of property to the former owner. In some cases, however, we are not able to sell or lease the property to the former owner because a feasible plan cannot be developed. I'm also aware of several requests from borrowers and applicants who are not the former owner/operators of the inventory property and at this time, no action is being taken on their requests to purchase inventory farms. I wish to assure you that we are continuing to lease and sell inventory property to the former owner if they are eligible for FmHA loan services and/or a feasible plan of operation can be developed.

FmHA Farmers Home Administration is an Equal Opportunity Lender.
Complaints of discrimination should be sent to:
Secretary of Agriculture, Washington, D.C. 20250

Paragraphs 4 & 5: Of the many important issues discussed at the meeting, two have an immediate impact on borrowers since deadlines set in the Agricultural Credit Act of 1987 have passed and we had questions on how FmHA has implemented these provisions so far. One issue is whether borrowers are eligible for income release. The other is whether they are eligible for homestead protection for land that was already in inventory as of January 6, 1988.

At the meeting you stated that those borrowers who were denied their right to income release will be reconsidered since the definition of "actively engaged in farming" has been clarified and is in fact broader than the basis for many of these initial denials. In addition, you stated that those borrowers who decided not to apply for income release because they felt they were ineligible may now apply for consideration. Because the instructions clarifying the definition were not received in local offices until a month after the deadline for application had passed, it is our further understanding the local offices will reissue letters to their borrowers. We would like to know of the efforts that have been made to publicize the change in definition and how many farmers have been reissued letters.

Response: We do not plan on reissuing letters to those borrowers whose accounts were accelerated between November 1, 1985 and May 7, 1988, to advise them again of the income release. We do not believe that FmHA's definition of "actively engaged in farming" has been a major problem for borrowers requesting income release. Borrowers whose request for income release are denied may appeal that decision. At this time there has been no request for appeals at the National level of FmHA's definition of "actively engaged in farming." We will notify accelerated borrowers of primary loan servicing programs, including debt restructure, once we implement the provision of the Agricultural Credit Act of 1987. If accelerated borrowers real estate becomes FmHA inventory property, the farm owner will be given rights to homestead protection.

Paragraph 6: The other immediate issue concerns whether prior owners of real estate held in FmHA inventory had received adequate notification about their rights under the Homestead Protection provisions of the new law. You stated that those borrowers who missed the April 5th deadline could still apply at this time and would be considered. Has any notification been sent to the State or local FmHA offices on this policy?

Paragraph 8: Members of the NSFFC worked hard to ensure that there were changes in both the nomination and election procedures and in the responsibilities of the FmHA County Committees. As we discussed at our meeting, we are very concerned about the restriction on only one FmHA eligible borrower being able to serve on the County Committee at one time. We raised the concern as to whether an appointed County Committee Member would have priority over an elected member and you assured us that you would not appoint an FmHA eligible member if one has been elected. We further discussed whether the appointments could be made for a one year term rather than the three year term so as not to preclude FmHA eligible borrowers from running next year. Would you please clarify your position on this?

Response: The Food Security Act of 1985 (P.L. 99-198) established a 3 year term of service for all County Committee members. We do not favor requesting that Congress change this provision of the Act.

Paragraph 9: We are aware that the proposed regulations governing FmHA appeals are currently in their 30-day public comment period. As we discussed at our meeting, we are concerned about appeals that may be ongoing now while the new process is being put in place. Since you agreed that borrowers with pending appeals may request a delay to utilize the new appeals process, have State Directors been notified of this policy? We have submitted written comments on the appeals regulations which we hope you will closely examine before finalizing the regulations.

Response: On May 11, 1988, State Directors were notified that appellants with pending appeals could elect to have their appeal handled under the new procedures effective July 1, 1988.

We received your comments on the proposed rule and are giving them careful consideration as we prepare our final rule for publication.

Paragraph 10: We appreciate your strong statement in support of state mediation programs and FmHA's National policy to fully participate in the programs. As we discussed at the meeting, we are very concerned about the role of State Directors in actively lobbying against new State mediation programs. We urge you to personally contact State Directors to clear up any misperceptions about their role in discouraging the establishment of state mediation programs. We also urge you to send a letter to the state legislators in these States where FmHA directors have

lobbied against mediation (such as in North Carolina and Tennessee) to clarify the FmHA's national policy. This will help correct any misinformation that may have been presented during legislative debate on the mediation issue.

FmHA is fully committed to the mediation process. Our field staff has been directed to participate in all certified State farm loan mediation programs along with other agricultural creditors on terms and conditions applicable to all.

We are not aware of our State Directors in North Carolina, Tennessee or any other State(s) having lobbied against the establishment of a farm loan mediation program in their States.

We have discussed our policies and proposed regulations on the farm loan mediation program with the FmHA State Directors and urged them to cooperate and participate in the farm loan mediation programs of their States if they have been certified pursuant to Title V, Section 501 of the Agricultural Credit Act of 1987.

Furthermore, we have notified all Governors of our authority to participate immediately in State farm loan mediation programs which have been certified. We have received responses from 34 Governors, with 25 expressing an interest in establishing a program and 10 requesting certification of their State mediation programs. As of this date, 7 States have received an interim certification of their existing farm loan mediation programs.

Sincerely,

VANCE L. CLARK
Administrator

Small election becomes battleground on farm policy

By SUSAN CRITTENDEN
STAR SPECIAL CORRESPONDENT

Vincennes, Ind. — For the second time in four months, two candidates are battling for a seat on the "county committee" — a body that advises the federal Farmers Home Administration in Daviess and Knox counties.

Beyond this simple election, however, lies a fundamental argument about the farm economy in the two counties.

Farmers and their spouses who vote will have a clear choice: Vicky Buckthal, a Freelandville board member running for re-election who says the federal program is doing well; or James C. Kerns, Vincennes, a farmer who's lost his farm and accuses the federal agency of being insensitive to the plight of those in trouble.

Stirring the debate is the cancellation of the original election in June, because of ballot irregularities.

"The ballots deposited (in the ballot box) were not within the rules of the regulations," said Oscar T. Blank, Indiana director of the Farmers Home Administration. "The ballots had to be either hand delivered or mailed by the person voting," he added. "In one instance, one person brought in five ballots. I called off the election."

The Farmers Home Administration, which dates from 1946, is the credit agency for agricultural and rural development in the U.S. Department of Agriculture. In Indiana, the agency currently has about $1.6 billion in outstanding debt, much of it in loans to farmers.

Loans are made both directly from FmHA or as guaranteed loans through another lending institution.

Area committees, according to the Agriculture Department, determine eligibility of those applying for loans; make recommendations on resolving problem cases; confer about borrowers who should be referred to other credit sources; recommend compromises or adjustments when requested by the borrower; and attend appeal hearings.

And while Buckthal and others downplay the role of the county committee, Kerns said that if he wins, he intends to use the position to help farmers who encounter the problems he's had.

"It's too late to help me. I've lost my family because of the stress related to farming. But if I can help one farmer down the road from losing his family because I can determine he's eligible for a loan, it will be worth it," he said.

"I'll never get back my family or farm, but my goal is to help another avoid the road I walked," said Kerns, 44.

Until 1986, FmHA county committees were appointed by the agency's state director. The director still appoints one member, but the others run for three-year terms on a staggered basis.

Committee members must be farmers or their spouses who have their primary operations within the counties to be served.

Mrs. Buckthal served as an appointed committee member until the first election. She can't recall just how many years that was, but in 1986, she won her first election to the committee unopposed, with only three persons voting, she recalls.

"This committee amounts to nothing. They usually can't get anyone interested. Not much to involved and there is little monetary allowance.

"Most of the men are farmers, and they don't want to take off to go to meetings, even though there are probably not five a year," said Mrs. Buckthal, 43, who does bookkeeping for a 1,200 acre family farm.

Kerns, meanwhile, is convinced that farmers are not getting the help they should and are discouraged by the paperwork involved in applying for loans.

"A lot of people have applied for loans. They are told they are probably not eligible, but fill out the paper. It's a lot of pages, and they are discouraged and throw them out. They need help.

"I think the supervisor should talk to them more, and I don't think he knows the rules and regulations thoroughly. A lot of partisan loans are made — if you're in the right clan, you can get the loan," he said.

Kerns, who is active in such farm organizations as Indiana Rural Crisis Group and Farmers Legal Action Group, is getting some help in his race from the Citizens Action Coalition.

John Cardwell, a spokesman for CAC, said the not-for-profit organization has been working with farmers for about six years. They have been encouraging farmers to run for their FmHA county committees for the past several years.

Paul Singleton, supervisor of the FmHA programs in Daviess and Knox counties, defended their performance.

"Our delinquency rate is among the best in the state. And 96 percent of our 183 farm borrowers are current, although we do a large, above-average volume. The same is true with housing loans," he said.

"I think this Indiana Rural Crisis advocacy group sees problems that they think their group can help farmers with. But as I see it, there is little they can do with a member on the loan committee," Singleton noted.

Singleton has been supervisor for 13 years. Programs he administers include both direct and guaranteed farm operating loans, farm ownership loans and disaster or emergency loans that involve the committee. Two other programs — direct or guaranteed rural housing loans and loans or grants to low income and elderly for home repairs — are outside the committee's jurisdiction.

Elections in Indiana's 30 FmHA offices went smoothly except for here, according to Singleton. Only four offices had any competition for seats.

According to state director Blank, the committee has two basic duties: to determine eligibility and to sign off on debt adjustment offers.

FILE PHOTO

Paul Singleton says FmHA programs work well.

"They do not have the responsibility some people think they have. At no time do they make credit decisions," he said.

The new election is in progress now, with final votes due by Sept. 30. And it is being contested just as vigorously as the first election, although members are only paid $30 per meeting plus mileage expenses.

While there are as many as 4,000 potential voters in the upcoming election here, only about 500 are expected to cast ballots. Both a farmer and a farm spouse are eligible.

Blank cancelled the prior election after a month of balloting, just before votes were to be counted.

Mrs. Buckthal can't understand why ballots were not counted after the June election, because she believes rules were followed like they were in other counties.

She said she almost didn't run again, "because it was such a hassle. It was blown out of proportion. But I had so many calls from people wanting me to run that I decided to. I'm not pushing for voters, but my supporters may be."

For this second round of voting, rules have apparently been tightened.

In June, voters could duplicate ballots printed in local newspapers or obtained from Singleton and use them to vote. This time only original newspaper ballots or ballots from the supervisor may be used, a factor that may work a hardship on farmers who did not receive a newspaper with the ballot.

Some will have to telephone long distance to secure one from the FmHA office here.

Instructions printed with the ballots for the second election do not state that a re-election is being held, and observers claim farmers who have already voted are confused. Although Blank admits there may be some confusion, he said he is operating within specific guidelines and does not have latitude to make changes.

The Des Moines Register July 29, 1988

Irregularity forces new Madison FmHA vote

By DAN LOOKER
Register Agribusiness Writer

The Madison County Farmers Home Administration has been asked by the state office of the federal lending agency to hold a new election for a seat on the county committee, a panel of three farmers that helps decide which farmers are eligible for FmHA loans.

The state office declared the Madison County election of June 30 void after it learned that one of the committee members, Winterset farmer Jack Thomas, had circulated absentee ballots and brought them to the county office, said Lee Johnsen, a program analyst for the FmHA state office in Des Moines.

"It's not a crime or anything like that, but our regulations state that absentee ballots need to be mailed or delivered by the voter," Johnsen said.

The new election will be held Oct. 28.

Another Winterset farmer, Bob Simon, said that he and a group of farmers discovered what they considered irregularities in the election and brought that to the attention of their congressional delegation and the farm advocacy group Prairiefire in Des Moines.

Besides reports that Thomas had circulated absentee ballots, farmers noticed that ballots were sticking out of the top of the ballot box on the day of the election, and when Simon's group asked to observe the ballot counting a few days after the election, they were told the ballots had already been counted. But the state office found no evidence that other election rules were broken.

"There's a small group of us here that pretty much felt something had to be done on this matter and had the courage to do it. Some of us are Farmers Home borrowers and in a precarious position," Simon said.

Thomas said Thursday that he doesn't recall exactly how many ballots he circulated. He said he also campaigned for one of the two candidates for the committee spot, Dale Lents, because Lents is from the southern end of Madison County and all of the committee members would have been from the northern end of the county had Lents' opponent, George Mueller, won.

"I have no regrets for what I've done. I thought I had the best candidate of the two," Thomas said.

Lents beat Mueller by a vote of 85 to 31 in the June 30 election, Simon said.

Dan Levitas of Prairie Fire said his organization was concerned about any election irregularities. Until 1986, all of the FmHA county committee members were appointed.

"We have fought long and hard to see to it that FmHA borrowers could serve on the county committee as well as that county committee members could be elected," he said. "Farmers Home has fought the democratization process every step of the way and now that we've won in Congress and the courts, we're determined to see that this isn't lost in the field."

STATEMENT OF JAMES T. MASSEY, EXECUTIVE DIRECTOR, FARMERS' LEGAL ACTION GROUP, INC., ST. PAUL, MN

Mr. MASSEY. Thank you, Mr. Chairman and Senator Harkin.

My name is James Massey. I am the lead counsel in *Coleman* v. *Lyng*, which is the national class-action lawsuit against Farmers Home Administration that was filed in North Dakota back in 1983 and which eventually was certified as a national case and now includes all 220,000 or 240,000 FmHA borrowers in that class.

Let me just as a preliminary matter—and I am sorry Mr. Clark is not here—say that this is probably the fifth or sixth time I have testified after Mr. Clark in the last 2 years before this committee and on the House side. I am stunned again by the disinformation that has been provided to this committee in the past, and I believe again today, on some historical aspects of program implementation, particularly in response to Senator Harkin's questions about Mr. Whitten's legislation.

I am a trial lawyer by nature and training and I am sorry that I do not have the ability to have Mr. Clark on the stand here. I understand that is not the style of this chamber, but let me just suggest a few of the things that I would ask Mr. Clark here that I think are important to point out to the committee.

OPERATING LOAN POLICY

First, Senator Harkin's comments about the operating loan policy are, at least in my experience, exactly right. The policy contained in Mr. Whitten's legislation was implemented by Farmers Home Administration without legislation and without any, as I recall, outside pressure or suggestion. It was designed by Farmers Home when Mr. Schuman was the Administrator and Mr. Schuman, of course, worked for Mr. Block.

The operating loan policy that was finally incorporated in Mr. Whitten's bill, which was intended to be exactly what the agency had done in 1982 to 1984, I believe, sat without implementation for the entire operating loan season last year. The bill passed in July. This is not—and let me just say from other experiences—this is an agency that when it wants to publish regulations quickly, it knows how. When it doesn't want to publish regulations quickly, it then presents testimony here about how complex these things are and they take many layers of consideration.

Well, this is not complex. All Mr. Whitten said was to reimplement through this program what you have already had onboard. All Mr. Clark had to do was take a piece of paper and say "it is onboard again."

Well, we wrote a demand letter to Mr. Clark—and maybe we should take credit for this move to socialism—demanding that Mr. Whitten's bill be implemented through regulations. And we were slow on the draw I have to confess. I think that letter went in February to Mr. Clark prior to any agency action on that bill.

What this demonstrates to me—as I pointed out in my testimony—is that when this agency does not like a program that is passed by this Congress, historically what it has done is hunkered down and said, "we are not going to do it."

It often doesn't matter whether the statute is enacted through regulations. I pointed out 8 or 10 examples in my testimony—it doesn't even matter if the agency has regulations, they are often ignored. The first part of the *Coleman* case had to do with enforcing Farmers Home own regulations. These required release of living and operating expenses so people could survive on their farms and feed their kids and pay their local creditors until they had a fair chance of applying for the options that were available, and had a fair foreclosure process.

When we sued on that and won, Farmers Home response was two-fold. First, they repealed those regulations. They did not want the money to be released. Congress came back in the Food Security Act of 1985 and said no, this is a long-standing policy of the agency itself. It is important to keep these people out there. We want you to do it. Farmers Home then created loopholes to the court order, and we had to go back to the judge in North Dakota and those loopholes were declared illegal.

The point is that—and I think the point was made today, finally—is that there has been entrenched ideological resistance in this agency to implementation of programs designed by the Congress, and in fact to programs the agency itself has administered for many years.

When Farmers Home loses a battle in this chamber, as it did on the limited resource loan program way back in 1981 and 1982 when it asked Congress to eliminate the program, it simply sits on the money; $120 million in each of 1982 and 1983 fiscal years went unspent when 14,000 FmHA borrowers went out of business.

COLLECTION AGENCY ISSUE

The collection agency issue. Congress passed a law in 1985 that in fact every other agency of the Government does get to use, I guess, except Farmers Home. But, again, I agree with Senator Harkin. We did an analysis, in fact wrote a demand letter back in 1985 or 1986, telling the agency that if it did not discontinue with the collection policy it was using through the New Jersey and, I think, Pennsylvania outfits, we would file a lawsuit.

Just before that the Congress stopped the practice for the reason cited by the Senator—that Farmers Home was violating its own regulations which required a debt settlement consultation and consideration of borrowers before they were placed on what is called the "collection only" category, the category of borrowers that was sent off to this collection agency.

Farmers Home violated its own requirements, and Additional Notice requirements within the collection act itself.

MEDIATION

Mr. Clark indicates that FmHA has worked with all the States and that the agency is enthusiastic about the mediation process. Minnesota's request for certification under the 1987 act was denied by Mr. Clark initially for three reasons that do not even appear in the statute. He did not tell you that. It was only after a threat of litigation from my office, the involvement of the attorney general

of the State of Minnesota, and very intense negotiations, that Minnesota's mediation program was finally certified.

Minnesota was one of the first States to request certification. Along with Iowa, Minnesota was the leader with the first program in the country—or maybe Iowa's came in a little sooner; but only after the threat of litigation did the agency recognize the program.

I appreciate the comments Mr. Clark made about our comments on these regulations. We did spend hundreds of staff hours and a substantial amount of out-of-pocket expenses developing comments on the proposed regulations. Apparently, many of those comments were adopted by the agency.

Again, what he did not tell you was that the issues that were raised in those comments were directly derived from litigation in *Coleman* v. *Lyng,* in which the agency's previous policies were declared unconstitutional by Judge Van Sickle, and under the threat of continued litigation on behalf of our clients if Farmers Home did not publish regulations that carried out the intent of the act.

I have to tell you there was a great debate in my office about this and it reminded me of one of my first clients when I was just out of law school and represented prison inmates against the Utah State Prison. The first complaint I drafted said, in the end, that the prison should be enjoined from putting my client into solitary confinement "without providing the following due process. . . ." My client read the complaint and he said, "well, why are you telling them how to do it?" I said, "what do you mean?" He said, "I don't want due process—I don't want to go to the hole."

That has stayed with me for many years. And it has been the policy in our organization in working with farm clients for the last several years that, if our judgment is that we are working with a hostile agency that with all the due process in the world the agency is still going to put it to them—in very blunt terms—we have maintained a very rigid line in the past about not telling the agency how to do it. FmHA has always gotten up in court and said, "Your Honor, these people did not submit comments, by God, and they are suing us in court here."

We did not submit comments on most of the previous programs because we felt that the programs were so fundamentally flawed, and the agency was so fundamentally hostile, that it was a disservice to our clients to assist the Government in designing programs that met constitutional standards but would be used to foreclose on their farms. My gosh, they have, I do not know how many attorneys they have in the Justice Department; I have five on my staff. Why should we do the dirty work for them?

So, we had that debate again this time and I lost.

I took the hard line again. I said absolutely not, these people are got going to implement this act in good faith. And the vote was—I cannot remember the vote but I was in the minority. And so we did write extensive comments, we did hire our readability expert who had testified in *Coleman* v. *Lyng,* and we did submit form notices.

We did that, and the reason the majority prevailed was that they felt that the Congress has invested so much time and energy and good faith and political capital on both sides on this bill and that Congress was tired, our clients were tired, and that FmHA needed to get on with this loan restructuring. That was the prevailing ar-

gument, that we have to move ahead. We cannot sustain—financially and politically and emotionally—another 5 years of *Coleman* v. *Lyng* litigation where everybody hunkers down.

So we went ahead and did this and let me just prognosticate a minute, if that is a verb. When those notices were issued that we assisted in drafting, when you read the Wall Street Journal, the Wall Street Journal is going to say that Farmers Home has today started the $8 billion give-away. That is what the Wall Street Journal will say.

When you go out to a broke farmer in South Carolina who gets the notice, he is going to say, God, they are foreclosing on me again; can they do this? And that is how that farmer is going to see the notice and that is how people who represent the farmer are perhaps going to be forced to respond to those notices. I think it presents a great predicament for this agency and/or everybody involved in this act in terms of public perception, both from the Wall Street Journal perspective and my broke clients's perspective about what exactly are we doing here.

Are we liquidating 120,000 or 150,000 farmers? Or are we beginning a process of fairly considering these loans for alternatives to foreclosure and a constructive solution to a very complex problem? My bottom-line argument against assisting the agency with these regulations was, I will tell you what Mr. Clark is going to say when he goes out and hits the road and he is talking to angry farmers instead of rotary clubs. He is going to say, "Congress made me do it and Massey told me how."

And if that happens, first I am going to say, "I told you so" to the rest of my staff. But I am going to be very upset, and it is not a personal thing. It has kept me in a job for the last 5 years chasing him around, but it is a disservice to the bill and it does play both ways. Mr. Naylor used to do this when he was the Under Secretary of Agriculture. He came up to North Dakota once and he sat right in front of a room full of farmers and said, you know, this judge here in North Dakota through this court order has forced us into procedures resulting in liquidations and denial of loans, and he cited the *Coleman* v. *Lyng* case specifically for revoking this continuation loan policy discussed here today. That is a conclusion that perhaps very few people understand.

So, the message I came with today is—I appreciate on behalf of my clients the committee's diligence in overseeing the Farmers Home Administration. I have spent over $1 million in the last 2 years trying to do what little we can do from our perspective. And if you work for a grassroots or nonprofit group, $1 million is a lot of money. It is hard to raise. It is hard to decide how to spend it. It is hard to do the work when you are always having to look—with one hand you are working, with the other hand you are trying to raise more money to keep the work going. And I just want to talk a few more dollar issues and then I will give up here.

You know, Farmers Home goes to the press and says, we are going to lose $2 billion and it is going to cost this and that. Well, I want to talk about money, too, and I want to repeat what my colleague, Dale Reeseman said to Judge Van Sickle when Farmers Home, specifically Mr. Hertzler, came in with an affidavit talking about how much money was involved in the *Coleman* v. *Lyng* case.

Dale Reeseman, who is a colleague of mine from Missouri, got up and said, "Your Honor, these are some very big numbers, but whose money is this?" According to Mr. Hertzler, in an affidavit in *Coleman*, the 13,000 borrowers that Farmers Home illegally accelerated between November 1, 1985 and May 7, 1987, have had $600 million of their produced farm proceeds taken by the agency during that period of time.

According to those figures, the accelerations that have been halted under those regulations in the intervening months have saved farmers $952 million. And, if Farmers Home does in fact succeed in liquidating the 50,000 borrowers that it says are already destined for failure even under the new bill, it is $2.62 billion in farm proceeds that will stop flowing to local communities.

This is farm proceeds. It isn't Government welfare checks and loan checks. This is farm proceeds from the production of food and/or fiber.

Well, those dollars turnover in rural communities four, five or six times, whatever—economists have some formula—when they go to pay the local feed lot, feed store and the taxing authorities and so on. They do not do that when they are pulled right back into the Treasury.

I am not here to say, and I have never told a client that debt is not to be paid. And my clients do not believe that. They want to pay their debt when they can. But, if they are illegally or unfairly liquidated, those farmers, every one of them, according to Mr. Hertzler, turns $70,000 back into that local economy every year just in living and operating expenses from the farm.

And that is a form of rural economic development, a form of jobs, I think, that we have to be aware of. So I urge the committee to continue this process of oversight. I join with Mr. Swenson and Mr. Bunting in the specific concerns they have raised. We will file additional comments on these new regulations.

Senator BOREN. I was going ask, are there any particular regulations other than those that have been discussed that you have real concern about?

Mr. MASSEY. Well, the minority assistance programs, I think, are particularly vague and without any teeth, and this agency, again, has a history of very substantial discrimination and lack of minority assistance in the past. It made its own finding last year in east Arkansas of pattern race discrimination. So, I think, for an agency with that kind of history, one could expect more than some sort of vague window dressing.

The shared appreciation recapture provisions are very problematic and we will continue to try to work on some comments to resolve those. We can always make the stuff better—but good regulations, even if they are letter perfect are not enough. I am more concerned by an agency that is run by somebody who is going around with the kind of rhetoric that Mr. Clark is and what that signals to his people.

I have taken depositions of I do not know how many Farmers Home County Supervisors around the country in how many States. We have given lectures and seminars in 35 States to 150 different farm organizations and 10,000 individuals. And, as I have heard Senator Conrad and Senator Harkin repeat many times, you

cannot understand how badly this agency can function unless you get out in the field and listen to those people and take the depositions of those front-line people. Unless they have positive leadership on this bill from the top, and are told that this is now the policy and it is a good one because Congress enacted it, we are going to have another disaster. I think it is only going to be through the kind of pressure and continuing oversight that this committee has exercised through the course of developing this bill, and hopefully through the implementation process, that will assure that the bill will be properly implemented.

I appreciate the subcommittee's time.

[The prepared statement of Mr. Massey follows:]

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TESTIMONY OF JAMES T. MASSEY
BEFORE
THE SUB-COMMITTEE ON AGRICULTURAL CREDIT
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
U.S. SENATE
SEPTEMBER 30, 1988

My name is James T. Massey. I am the executive director of Farmers' Legal Action Group, Inc. I am testifying today at the invitation of the committee. I do so on behalf of the 240,000 FmHA borrowers I represent as lead counsel in Coleman vs. Lyng, a national class action lawsuit currently on appeal to the United States Court of Appeals for the Eighth Circuit. My colleague, Lynn A. Hayes, appeared before a panel of that court September 19, 1988 for oral argument of the case.

The government, in its appeal, is seeking to have the appeals court dismiss the entire case, claiming it was rendered moot by passage of the Agricultural Credit Act of 1987. That failing, the government seeks outright reversal of the judge's order. The farmers in Coleman, my clients, argue that the 1987 Credit Act does not render the case moot, principally for two reasons.

First, Judge Van Sickle required in his 1987 orders that FmHA submit to the court, for review and approval, any new forms and notices it adopts to advise borrowers that it intends to accelerate and foreclose on their loans. In this procedure the farmers will have the opportunity to explain any objections they have to the procedures or, if necessary, to seek further court assistance to modify or halt procedures they deem to be legally inadequate. FmHA clearly does not want to undergo this process of judicial oversight.

Second, the farmers have also appealed from the 1987 Coleman orders. They ask the Appeals Court to reverse Judge Van Sickle's limitation on relief granted to the 13,000 FmHA borrowers whose loans were accelerated by FmHA through unconstitutional procedures between Nov. 1, 1985 and May 7, 1987. As this committee will recall, FmHA was enjoined from taking further foreclosure or liquidation action against this group unless new procedures were adopted by FmHA and approved by the court. The court did not, however, set aside their loan accelerations, declined to order restitution of the farm proceeds taken directly from these farmers, or the farm program payments offset from ASCS, and

further declined to reinstate these borrowers' right to release of living and operating expenses from farm proceeds.

The farmers appeal this limitation, seek restitution of these funds and ask the Appeals Court to declare void and set aside the 13,000 accelerations. They do so for one very compelling reason--money. These 13,000 borrowers are being starved off of their farms every month as FmHA continues to take farm proceeds. By FmHA's own estimates, submitted in a court affidavit May 20, 1987, FmHA has now taken approximately $682 million from these 13,000 farmers. Our clients want their money back so they can feed their children, pay Main Street creditors and continue their operations until they are considered fairly for alternatives to foreclosure.

Clearly, the Coleman case remains essential to thousands of FmHA borrowers.

Against this backdrop of continuing Coleman litigation, this committee is now overseeing FmHA's performance, to date, under the Agricultural Credit Act of 1987. On this score there is some good news, tempered however, by continuing efforts by top FmHA officials to sabotage and undermine the purpose of the 1987 Act, and this committee.

The good news is this: FmHA, for the first time in our experience, appears to have taken seriously Judge Van Sickle's 1987 orders and our comments indicating how the proposed regulations published May 23, 1988 were unacceptable under those court orders. In short, under the threat of continued and protracted litigation, FmHA adopted final regulations September 14, 1988 that, in most key respects, address the Coleman orders and are responsive to many of our comments. They are not perfect, and some issues may still end up requiring court resolution, but they are substantially better than FmHA's proposed regulations.

However, we are very concerned about the practical implementation of the regulations at the local office level. The debt restructuring calculations are going to be run through a computer program. It is very important that farmers receive complete information on the figures FmHA puts into the computer when considering the debt restructuring application. Without this information farmers denied restructuring will not have a fair opportunity to appeal or contest FmHA's decision.

There are many farmers, farm organizations, legal services programs, lawyers, extension offices and farm management programs throughout the country who are attempting to assist financially distressed farmers to negotiate with FmHA. Many of these organizations assist farmers in developing their farm plans. They will not be able to provide adequate

assistance to farmers applying for debt restructuring unless they have access to the same computer program the FmHA offices will be using. We ask this committee to encourage FmHA to make the DARL$ program available to the organizations, so that they can effectively continue to assist distressed borrowers.

We also ask that this committee closely monitor the implementation of the minority rights provisions in the Credit Act. This country faces the potential loss of a very large percentage of black, Hispanic, and Native American farmers and ranchers in the next few years. Congress has made it clear through the outreach and targeting provisions of the Credit Act that FmHA is to use its programs to prevent the loss of minority farmer ownership of land. However, FmHA's outreach and targeting regulations are vague and without close monitoring and enforcement, will have very little impact on preventing blacks, Hispanics, Native Americans and other minority groups from losing their land.

To the bad news. Any optimism that the new regulations signal an acceptance by FmHA of the worthiness, the workability and the commercial soundness of the restructuring provisions of the 1987 Act was squelched Thursday, September 22 by the following U.P.I. report of comments made by Mr. Clark (taken from Ag. a.m.):

> **FmHA PUSHED TOWARD SOCIALISM** (UPI) -- FmHA Administrator Vance Clark said the $2 billion that the agency will lose this year is the result of liberal legislators pushing the agency toward socialism. FmHA collection efforts have caved in to special interests and the portfolio is very stressed with $7.3 billion in delinquent loans. Clark prefers privatizing the loans with FmHA guarantees of 90%.

Thus, on the eve of implementation of the 1987 Act, this committee and both Houses of the Congress stand accused by Mr. Clark of "pushing the agency toward socialism." Ignoring for a moment the outrageous demagoguery evidenced by Mr. Clark's comment, let us look once to the purpose, and the method, of this legislation to determine if there is any truth to his alarm.

First, the several billion dollars FmHA will lose this year and the next several years is not a product of legislation; it is a product of a devastating farm financial crisis that has now been going on in much of the country for nearly a decade. If, indeed, it is a product of interest groups and socialist legislation, as Mr. Clark would have it, why then are not the American Bankers' Association, the FDIC, the Farm Credit System and America's thousands of independent banks blaming these forces? Because it is not true.

Second, is FmHA going to lose additional money because of the 1987 legislation? Of course not. The restructuring provision of the Act requires FmHA to restructure loans, and continue with delinquent borrowers, only if to do so will be less costly to the government than loan foreclosure. Indeed, this legislation was enacted to change rigid FmHA policies that forced liquidations even where it cost the government a great deal more than restructuring or debt settlement.

I testified on this issue in April, 1987, explaining the background of Hansen vs. Lyng, a Minnesota Class Action lawsuit filed in 1987 challenging these FmHA policies. We had attempted in 1986, through direct negotiations with Mr. Clark, to convince him that FmHA's policy--of demanding complete liquidation of all loans and security property before engaging in any debt settlement discussions with the borrower--was unreasonably costly to the government, unfair to borrowers and perversely unique to FmHA in the community of commercial lenders. Mr. Clark made it clear, however, in a December 1986 letter, that FmHA's policy would remain the same.

Mr. Clark subsequently testified before this committee that the restructuring provisions of the 1987 Act would "cost" the government upwards of $7 billion. When pressed by a member on this issue, however, Mr. Clark admitted that these billions, which presumably include the $2 billion he projects FmHA will lose this year, were already lost to the government because FmHA loans were unsecured to such a great extent, and the total cash-flow of its borrowers was so seriously impaired. Thus stripped of the "cost" argument, FmHA was left only with the claim that the restructuring provision would send the wrong message to borrowers, and encourage them not to pay. This committee is smarter than that, however, and has drafted a bill which prevents abuse of the restructuring provision by those able to pay.

In short, the 1987 Act codifies sound commercial practices used day in and day out by private commercial creditors throughout the entire country. Given this fact, we urge the committee to scrutinize carefully the true objectives, as well as the nature, of Mr. Clark's continuing attack on this legislation. Our conclusion is that his comments signal, in light of the passage of the 1987 Act over his objections, a turn from an ideologically driven policy of farm family displacement--now prohibited by the Act--to a strategy of ideologically driven demagoguery, carefully calculated to undercut the credibility and workability of this legislation, this committee and the entire FmHA farm loan program.

Taken in a vacuum--that is, as an analysis of strategic executive resistance to a Congressional mandate--Mr. Clark's

comments would be troubling. In the context of FmHA's recent history of practiced recalcitrance, and resistance to implementation of legislation, this strategy appears designed to produce another chapter in a continuing tragedy. That chapter, familiar to FmHA borrowers and those of us working with them, will be one of fierce resistance to actual implementation of this legislation, and FmHA's own regulations, at every step of the new process. I say that for several reasons.

First, Mr. Clark now signals to FmHA staff throughout the country that FmHA has been bludgeoned unwillingly into this restructuring program by "liberal legislators" and that they must now--as agents of the United States government, engage in activities "pushing toward socialism." Surely, this message alone is a sufficient, audible signal from Mr. Clark to his team calling for a goal-line defense.

Second, FmHA's purported "study" of the impact of the 1987 Act on its delinquent borrowers adds to the agency attitude toward implementation. Essentially, this "study" has already signalled to FmHA field personnel that no more than 15% of all delinquent FmHA borrowers will be eligible for restructuring through write-off of unsecured debt, while nearly 50% are now targeted for liquidation.

Finally, lest it be thought that a good statute, and a reasonably good set of regulations, are sufficient to survive a gauntlet of ideological and bureaucratic resistance to implementation, FmHA history teaches otherwise. Several examples of FmHA conduct in recent years demonstrate that this agency--with or without legislation, and with or without regulations--generally does exactly what it wants to until stopped by the courts.

The Deferral Statute

The deferral statute at the core of Coleman vs. Lyng, and two dozen other cases filed between 1981 and 1984, was passed by the Congress in August, 1978. FmHA refused to adopt regulations implementing the statue until November 1985, following four years of litigation in which the government raised every possible argument why the deferral relief passed by Congress should not be made available to farmers. And, when FmHA finally implemented the program, it did so through procedures so fundamentally restrictive and unfair, they were declared unconstitutional.

Limited Resource Loans

When FmHA was unsuccessful in 1981 and 1982 in its efforts to have Congress eliminate the Limited Resource Loan Program, it simply quit spending the money. In fiscal years 1982 and 1983, despite clear congressional expression of need and support for the program, FmHA

let $120 million of spending authority for the Limited Resource program expire in each year, enough to assist 10,000 borrowers. During this same period of deepening farm financial stress, more that 15,000 FmHA borrowers were forced out of business and lost their farms. At the same time, FmHA's rate of farm acquisition tripled.

Release of Living and Operating Expenses

FmHA's own regulations, beginning in 1979, required the agency to release sufficient farm proceeds from FmHA's security interest for its borrowers to meet living and operating expenses. Notwithstanding this regulatory mandate, FmHA began in 1981 to unilaterally terminate releases of living and operating expenses to its borrowers without any form of due process, and without consideration of alternatives to liquidation. Most borrowers in this situation were simply starved out of business and off their farms. This practice was declared unconstitutional by the court. FmHA then created three "loopholes" through interpretation of its regulations that, again, rendered most borrowers ineligible for releases of proceeds. These loopholes, too, were declared illegal by the court.

Finally, again stopped by the courts from this practice, FmHA immediately took steps to repeal this long-standing regulation altogether so it could resume "foreclosures by starvation." This led to enactment of a provision of the Food Security Act of 1985 which, again, required such income releases.

Non-Interest Bearing Supervised Bank Accounts

FmHA's regulations authorize the use of supervised bank accounts, for up to one year, with the borrower's consent. Nonetheless, FmHA has for years required use of non-interest bearing, supervised bank accounts by many of its borrowers, again, in direct violation of these regulations.

Restrictions in Dairy Loans

FmHA statutes and regulations set out farm loan eligibility and approval standards. For a number of years, however, FmHA imposed additional lending restrictions on dairy farmers without legislative authority and without authorizing regulations. This dairy lending restriction resulted in farmers being unable to replace cows, to repair or upgrade facilities and to maintain existing herds. Again, this restriction was in direct violation of the farm program statute and FmHA's own eligibility and loan approval regulations.

Loan Application Refusals
FmHA's regulations require FmHA to make loan applications and program information available to anyone who wishes to apply. FmHA personnel have, however, for years refused to allow some borrowers to apply or have told them, without reviewing any figures or plans, that they will not be eligible. This is particularly a problem for minority, female and older farmers, a fact underscored by FmHA's own findings in 1987 of race discrimination by its state and local personnel against black borrowers in eastern Arkansas.

County Supervisor Overreaching
FmHA county supervisors in some counties routinely usurp the function of the county committee, in direct violations of FmHA regulations. FmHA regulations set out a two-part loan application consideration process. Under these regulations, the FmHA county committee is to determine the applicant's eligibility for an FmHA loan. This determination is based on numerous statutory and regulatory criteria. The county supervisor's role in the process, if the applicant is found eligible by the committee, is to determine loan approval. Loan approval is based only on repayment ability and adequacy of security. Despite this allocation of responsibility, county supervisors, in many instances, actually make both the eligibility and the loan approval determinations.

Appeal Violations
FmHA has for years had regulations granting borrowers the right to appeal "adverse" decisions. It was not until the Coleman and related litigation was filed, however, that borrowers were ever notified of and given access to appeal procedures in these circumstances.

These few examples are given to reinforce the point made above--statutes and regulations alone do not assure compliance with Congressional mandate and purpose, particularly by FmHA. In this agency, an ideology hostile to Congressional mandate and purpose has, time and again, generated resistance to implementation of FmHA programs, and direct violation of clear statutes and regulations.

The cost of FmHA's conduct to borrowers, to their advocates, to the agency, and to rural communities, has been high. As noted above, FmHA has, by its own estimates, stripped over $600 million in farm proceeds from the 13,000 borrowers whose loans were accelerated between Nov. 1, 1985 and May 7, 1987, funds which otherwise would have gone into Main Street business communities, rural taxing authorities and local creditors. According to these same FmHA figures, the Coleman litigation has stopped the agency from taking an additional $952 million in farm proceeds from borrowers

whose loans it was attempting to liquidate through its illegal procedures. And, if FmHA's "prognosis" is correct, more than 50,000 of its borrowers will now be liquidated because FmHA's "study" has already determined that they will not qualify for any primary loan service alternative under the 1987 Act.

The financial implications to these borrowers and their rural communities is staggering. According to FmHA, these 50,000 borrowers, on the average, return $2.62 billion per year of their farm proceeds to their communities through expenditures for family living and farm operating expenses. Those dollars, economists tell us, turn over five, six or even seven times in local, rural economies. Their loss will be substantial, to say nothing of the social and cultural loss of these farmers to the community.

Finally, FmHA's refusal over these years to implement programs and, indeed, to comply with its own regulations, has cost borrowers, tax payers and the government tens of millions in attorney fees. In fiscal years 1986, 1987 and 1988 to date, more than 16,000 FmHA borrowers have filed bankruptcy because the agency refused to reasonably negotiate debt settlement or implement a viable loan deferral program. The average cost of a Chapter 12 farm bankruptcy across the country is approximately $10,000. The average cost for Chapter 11 bankruptcies is even higher. If even half of these 16,000 bankruptcies have been Chapter 11 or 12 efforts to restructure debt, attorney and trustee costs on the borrower's side have exceeded $160 million. And, to this, must be added the government's cost for administrative and legal work to respond to these filings. Many, if not most of these bankruptcies could have been avoided, and these millions saved for production and living costs, if FmHA had charted a different course in these years.

The Coleman litigation, by comparison, has been a relative bargain. The first stage of the case, completed in 1983 and 1984, resulted in an attorney fee award, paid by FmHA to the farmers' attorneys, of $185,000. Since 1984, the case has cost, an additional $300,000+. However, these several hundred thousand dollars have been obtained from hard-pressed legal aid programs whose funds have been cut during this period, from charitable foundations beset by hundreds of requests for help, from state appropriations, and from several private attorneys who have given time without compensation.

Finally, the Congress has spent untold millions overseeing, analyzing, deliberating, and finally legislating an Act that requires FmHA to do what any sensible creditor--and certainly a reasonably managed government program accountable to a bottom line--would have done by choice, and

what the agency could have done under its existing statutory authority before the 1987 Act was even written.

Our message to this committee today, and for however long it takes for this bill to be properly implemented, is this: The agricultural Credit Act of 1987 is not self-enforcing, FmHA's new regulations are not self-enforcing; they certainly do not guarantee that the Act will be properly implemented. And, as made clear by Mr. Clark, FmHA's policy makers--and chief administrator--remain hostile to this legislation.

In light of these facts, and particularly in light of FmHA's outlaw conduct in recent years, we ask this committee to continue a rigorous oversight process during the implementation of these programs. This FmHA should not be allowed--whether through outright defiance of Congressional mandate as it did in the early 1980's, or through bureaucratic inertia and obstruction inspired by the demagoguery today--to obstruct the Congressional directions contained in the Act.

Our clients do not have funds left to file thousands of bankruptcies or wage individual legal defenses. We cannot fund nationwide litigation indefinitely with charitable funds and state appropriations. FmHA must simply be made, by the Congress, to be a law-abiding government citizen of this country.

We appreciate the committee's interest, and its continuing attention to our clients' concerns.

Respectfully submitted,

James T. Massey
Farmers' Legal Action Group

Senator BOREN. Well, I think you are absolutely right. That is one of the reasons why we had the discussion we had today. It is disheartening, you know. Here we have all worked together on this and I, frankly, think if I had been voting in the vote that you recounted here to us, I would have voted with the majority and said, well, let's try to make this work because we have had to go through an adversarial process.

I compliment you on the quality of the work that you have done on the *Coleman* v. *Lyng* case. I know you have spoken before to our State attorneys general on this matter in their meeting. But it is just absolutely terrible the amount of financial resources, the amount of time, the amount of emotional energy that has to be spent to get people simply to carry out the law as it was written and the system as it was written. It is such a terrible thing for everyone involved. It is a frustration of our constitutional process, a process which puts lawmaking authority not in the hands of the bureaucracy but in the hands of the legislative branch once the President signs a matter into law, as he has done in this case, and I think it is imperative.

You are absolutely right, this bill can work. I am convinced it can work. Today there are still some changes that need to be made at the margins on these regulations. There needs to be some further refinements made that are important. But I am convinced this law and basically these regulations, the main thrust of them, can work. But it will only work if the right signals are sent. If the signal is that we are all going to grit our teeth and be good soldiers, we hate all of this, it is awful, it is terrible for the country, it is heading us in the wrong direction but we will try to look at least like we are living cosmetically within these rules, it is not going to work.

It is going to take a signal and if County Supervisors, and others, who carry this out get the feeling that they are sure not going to get any bonuses, they are sure not going to get any promotions if they really get out here and break their backs trying to live up to the spirit of this law and really make it work, and that in fact, they are going to be frowned upon by their peers within the agency if they do get out and make it work, then all of our scrutiny of the law itself, all the hundreds of hours we spent writing the law was useless. This was a law written by committee in a way that I have never seen it done before. The amount of detailed work by members was incredible on this, and the amount of scrutiny of the regulations has been of great magnitude.

But that is not going to do any good if it is not implemented according to the right spirit, and I think you have put your finger right on it. We are determined to try to do that and I think that—you know, if Mr. Clark had been going around making the statement that this was a good law built on a bipartisan consensus and that they had really gone all out to write regulations to carry out the spirit as well as the letter of that law and now we are all going to go out and try to make it work, I think that if he had come in this morning with the very same things that are in these regulations but having come in with that kind of attitude, that kind of signal being sent instead of the signal that was sent that this is a terrible thing we are being coerced into doing, he would have had a

very, very favorable reaction from this committee today instead of the very disturbed reaction from members of this committee that he received today.

It is not a matter of what is on paper in the regulations. It is a matter of the signals that must be sent by the leader of an agency. So hopefully that message was received this morning. I hope so. I do not see how it could have been any clearer. We do not know at this point who the next Administrator of that agency will be but we are going to sit down with the next person in that job very early on and let them know that we are watching and watching aggressively and we mean for the oversight process to work. We mean business and we are going to give them an opportunity to get out and send the right signals, but if they do not, we are going to be right there looking over their shoulders. So I hope it will not prove to have been a failed effort and that the risks that have been taken, which I understand from a lawyer's point of view the risks that have been taken will pay off.

Senator Harkin.

Senator HARKIN. Thank you, Mr. Chairman, I am sorry. I have to go. I just want to publicly—as I have privately many times—congratulate you on your diligence, your courage and your patience in first of all getting this Agricultural Credit Act through—it was a Herculean effort on your part—and then for providing the kind of oversight that you have in following up to make sure that the act is put into operation—that the regulations are written and implemented—and for having this hearing today.

I can honestly say that many farmers out there through a variety of circumstances need and will be helped by this act—the farmers Mr. Massey has been fighting for, and Mr. Swenson and Mr. Bunting. You know, these farmers may never be the big, rich farmers with a lot of land and wealth, but they are farmers who can make a decent living. They can raise their families. They can be participating members of their communities, their churches, their rural schools. Their kids can grow up healthy and happy with good educations.

There is nothing wrong with helping to preserve that in our society. These are the kind of farmers that will benefit from this act. These are the kind of farmers that I hope know of your interest and support for them in our society and I just want to thank you.

Senator BOREN. Well, I appreciate your comments and I appreciate your participation and I hope you will keep right on with the tough questions. They need to be asked and I hope that all of those here, in groups represented here, will keep bringing information. We want specific information. When you have specific information of abuses, bring them to this committee. Bring them to me, bring them to our staff, to members of this committee. The members of this committee are concerned and perfectly prepared to haul people in here and ask for an explanation of what is going on and working together aggressively we can try to make this thing work.

As Senator Harkin has said, you know, I rarely have any groups of people come to see me that inspire me as much as the groups of kids in, our FFA kids and so on that come from farm families, that come in to visit with me from time to time. And you know you sit there and you think about the values these kids express. It is so

refreshing. And you talk about really being the backbone of what we like for this country to be all about.

And then you think about how quickly the opportunities are disappearing and you wonder how many kids are going to be in the next generation because how many of those kids are going to be able to stay on a farm and live in a rural area and have an opportunity to have the same kind of values expressed. And it is fast disappearing and we realize there are some tough economic conditions worldwide.

We understand that there are actions of other governments in the world, too, that interfere in the trading process and the rest of it that are making it very, very tough for them to survive. But when we see unnecessary failures, failures that could be avoided by simply following the spirit and the letter of the procedure that we set forth, it is heartbreaking to see that and it is absolutely unnecessary. And when your own Government is in there fighting you as well as all the other things you have to deal with when you are farming and you have to fight a bureaucracy that is out to hurt you instead of help you, it is just unforgivable.

So we are going to do our best and I really appreciate the contributions all three of you have made today and continue to make in all sorts of other ways to the common cause that we are working for, and we welcome further information from you beyond what you have been able to provide today.

Mr. BUNTING. Could I ask one more question?

Senator BOREN. Yes, sir.

Mr. BUNTING. There is one more group that I think we have not addressed and I would like to get information for them; the people who are in bankruptcy now, chapter 12's.

Senator BOREN. Yes.

Mr. BUNTING. A lot of people are in bankruptcy but the restructuring could actually help them when they cannot make their plans, because with the lease-backs that are available and the buybacks, the lease would lower their payment. Is there a provision in this bill?

Senator BOREN. Yes. If they are in bankruptcy, can they go back and take—I do not know the answer to that question. You are talking about people who have actually already filed under chapter 12?

Mr. BUNTING. Yes, and have a plan. In fact, most judges are saying—when people are asking for this, they are saying, he has already had his opportunity for restructuring, and what we need addressed in this is that there is opportunity for restructuring, even after the confirmed plan for people that are in bankruptcy. Because these provisions—interest rates, 13.5 percent for FCS, 9.5 for FmHA, but under restructuring you can get down to the——

Senator BOREN. Let me ask staff to comment on that. Can any of the staff help me with an answer to that, because I do not know the answer off the top of my head as to whether or not the provision provides for availability after chapter 12.

Mr. DUNN. Senator, I believe that a 45-day notice letter will be sent out to anybody that has not come to fruition on their chapter 12.

Senator BOREN. So in other words, if it is in progress but the final order has not yet closed down on the chapter 12, the restruc-

turing notice should come to them and the restructuring provision should be available to them. The question, does that hold the bankruptcy proceeding in abeyance pending the outcome of the restructuring?

Mr. Massey, do you know the answer?

Mr. MASSEY. Well, there is some experience already under the Farm Credit side of the bill. I think the answer is that until the circuit courts get hold of the variety of bankruptcy court decisions, that some of those questions will not be answered. For example, there is a split now between courts as to whether or not people whose debts have been discharged in a chapter 7 are nonetheless able to go through a restructuring. And I think what we are going to see, probably, is some of the things that are set out in the regulations, such as who will get the notice and who is eligible from an administrative standpoint. But if the debtor is in bankruptcy and has to petition, for example, for partial lift of the stay to get that consideration, I am not sure that the bankruptcy courts are going to be uniform in how they respond. The decisions under the Farm Credit side have been wildly disparate and from both ends of the spectrum.

If you talk to credit attorneys in one district they are very upset, and you talk to debtor's attorneys in another area they are very upset. I think the circuit courts are probably going to have to resolve that.

Senator BOREN. Whether or not it is in progress, they get the notice, but are they then able—does that then hold the action in abeyance until the restructuring determination is made? Well, we ought to look into that further. You raised a valid question and, of course, you can tell from the fact that there isn't any firm answer on that at this point that it is something that we need to look into, and we will do that.

Well, again, I appreciate all of you being here. We will stand in recess because the oversight process will be ongoing and continuing.

[Whereupon, at 12:35 p.m., the subcommittee adjourned, subject to the call of the Chair.]

EDITOR'S NOTE: On January 24, 1989, a second hearing was held with respect to the Farmers Home Administration.

[Material submitted for inclusion in the record follows:]

Services of Mead Data Central

Proprietary to the United Press International 1988

September 21, 1988

SECTION: Regional News

DISTRIBUTION: Wisconsin

HEADLINE: U.S. FmHA chief says agency's money losing ways got to go

BYLINE: By JOANNE M. HAAS

DATELINE: MADISON, Wis.

KEYWORD: Farmcredit

BODY:

The U.S. Farmers Home Adminstration will lose $2 billion this year, a financial deficit its administrator says is indicative of policies forced by liberal legislators pushing the agency toward ''socialism.''

Vance Clark said Wednesday the FmHA was established 53 years ago during the Great Depression as part of the Resettlement Administration and given the mandate to do everything possible to keep the American farmer on the farm.

''But is that an excuse for constantly turning out good money after bad? I don't think it is. It will lead to socialism unless we do something about it,'' Clark said during a speech before the Downtown Rotary as part of his Wisconsin visit. He visited Wisconsin Farm Progress Days in Janesville Tuesday.

Clark said his efforts to change FmHA policies are typically shot down by liberal Congressmen and Representatives who head key committees and are beholden to special interest groups vital to re-election efforts.

''I've been told 'Don't work too hard at collecting those loans,''' Clark said, referring to legislators who view such collection efforts as detrimental to a positive image in their home districts. ''It is so easy to cave into special interests ... It's a very sad state of affairs.''

Clark said the agency has made non-collectible loans for too long and receives too little Congressional supervision. ''We've become more a constant source of subsidized credit for too many farmers,'' he said. The taxpayers are footing the bill for the agency's policy of giving loans to too many extremely high-risk farmers, he said.

''Government should get out of direct lending. There are a lot of farmers out there who should not be farming. We're simply postponing the inevitable,'' he said.

Clark prefers privatizing direct loans so the FmHA would guarantee 90 percent of a loan offered through a private lending institution, which would assume a 10 percent risk.

Services of Mead Data Central

Proprietary to the United Press International, September 21, 1988

''We'll still be there when you need us, but we don't have a blank check to pay all the bills,'' Clark said.

Agriculture loans account for 15 percent of the FmHA's business, which includes loans to businesses and communities. The agency has loaned out $150 billion since its inception in the 1930s.

Currently, Clark said the FmHA national portfolio ''is very stressed'' by $7.3 billion in deliquent loans, including 81 percent that are three years or more delinquent.

''Well, we are the agriculture lender of last resort,'' Clark said.

IOWA FARMER/CREDITOR MEDIATION SERVICE

TESTIMONY OF MICHEAL THOMPSON
Iowa Farmer/Creditor Mediation Service, Inc.
Des Moines, Iowa

Before the
United States Senate Agriculture Subcommittee
Washington D.C.
September 30, 1988

Mr. Chairman:

I am pleased to comment on the FmHA rules regarding the implementation of the Agricultural Credit Act of 1987. In commenting on these rules, it is my intent to focus upon those aspects of the rules relating to negotiation and mediation. Before commenting on the specifics of the rules, it is important to note that I appreciate the time and energy devoted to their development. As a mediator I recognize that FmHA has been attacked by farm advocates, and it is my perception that these rules illustrate the battle mentality that exists. Accordingly, my biggest concern regarding the rules relates to the "win/lose" environment that seems to emerge.

This "win/lose" connotation is prevalent throughout the rules, but it appears to have a conceptual basis. The rules promote a climate of substantive due process as if legal rights somehow are the means by which farmers and creditors reach settlement. While many farm advocates agree with this approach, it has been the Iowa experience that this rarely motivates any party to settle. Instead, it diminishes interest negotiations and increases the likelihood of expensive legal intervention. Moreover, this approach ignores the fact that farmers and FmHA personnel <u>must</u> develop the commitment to resolution. This commitment does not occur in legal interactions, but it can occur when a dialogue is developed and the parties search for common ground. This common ground is the mutual goal established by Congress calling for reducing government loss while keeping borrowers on their farms.

Another aspect of the rules which promotes "win/lose" outcomes is the reliance upon the DALRS program. This program has been promoted as the ultimate decision making tool, "duex ex machina". Potential financial outcomes may be developed by the computer, however, these outcomes are contingent upon the data put into the program. While FmHA allows the borrowers to provide this data, it is not clear to the borrowers how the program works. Accordingly many farmers will <u>perceive</u> that the program is biased against them, particularly in cases where none of the primary loan servicing options can resolve

the impasse. This distrust is heightened because the DALR$ program has not been made readily available to the farm community. Because the DALR$ program is not available on DOS compatible systems, farm advocates and farm preparers will be unable to prepare proposals to fit the system, leading to the perception that it is unfair. Consequently, the farm community may believe it is acceptable to manipulate the system once its content is known.

This perception of unfairness corresponds to the concept of "good faith negotiations". The rules appear to detail "good faith negotiations" on the part of borrowers, but they do not prescribe similar "good faith" on the part of FmHA. While it may be self evident to FmHA that they will negotiate in good faith, it is not evident to the borrower community. This again reflects the battle mentality which exists, and it would be a demonstration of good faith if FmHA developed rules detailing that occurs if the farmer alleges bad faith on the part of FmHA.

In particular, farmers and their advocates believe that the FmHA rules have a potential for bad faith with respect to the authority to negotiate. These proposed regulations give the sole authority for debt-write-off to the State Director. Borrowers, therefore, will not believe that FmHA is negotiating in good faith unless the State Director participates in each mediation/negotiation calling for debt write-off. Because of the impracticality of mandating participation by the State Director in all of these cases, the absence of final authority will leave borrowers with the impression that they are being treated unfairly.

Other concerns arising from the rules stem from FmHA's reliance upon financial data as the sole cause for impasses. In many cases farmers believe that the issue is not the numbers, but rather their treatment by FmHA. Consequently, many borrowers will not be convinced that they are being treated fairly as long as the FmHA supervisor (their enemy) develops and enters the critical data. This perception is exacerbated as long as the DALR$ program is not available to the borrower.

Although the credibility of loan officers is important, another kind of impasse that can occur involves those cases where the borrower can not cash flow. The DALR$ program will not remedy the issues, and FmHA staff must negotiate a means for the borrower to leave. Unless FmHA personnel receive training in this regard, the likelihood of reducing costs to the government is minimal, because a transition phase will not be developed. This transition phase is critical because it can allow borrowers the time and space to make plans and develop options for leaving, while still maintaining their integrity. Accordingly, the rules need to provide FmHA personnel with a means of assisting with the creation of these plans. This will reduce the reliance upon legal options such as bankruptcy for handling FmHA cases.

Because the preceding concerns are not addressed in these rules, it is my impression that many negotiations will break down and mediation will occur. While mediation can certainly be valuable, the approach developed in the rules seems to be predicated on the belief that mediation's only value is to convince other creditors to negotiate. In fact, most other creditors have already negotiated, and will attend mediation expecting FmHA to make concessions. Until FmHA staff are fully trained to search for positive options in negotiation/mediation,

the potential is high for bad faith allegations against FmHA. Obviously this will not be instrumental in meeting the goals of Congress.

To remedy the preceding concerns, I recommend that the rules be changed through a regulatory negotiation process. This process, which was conducted in Iowa for the Farm Credit Services portion of the Ag Credit Act, allows the involved parties (FmHA, farmers, advocates, mediators, and Congressional Representatives) to discuss and negotiate alternative methods of establishing rules. This process has been discussed in Congress, and I believe that these rules would be an excellent trial run for examining the regulatory negotiation model.

If this approach is not deemed to be useful, I would urge that the following specifics be altered:

1. Mediation will be available to handle impasses at any time an impasse occurs;
2. FmHA will attend mediations even if other creditors are not involved;
3. Bad faith standards will be set for FmHA, or safety valves will be established to insure that FmHA participates in good faith;
4. Negotiation/mediation of non-financial impasses will be mandated, and FmHA staff will be trained to search for any reasonable option;
5. FmHA will provide the DALR$ program to farmers, farm advocates, and farm preparers, prior to the actual negotiation time frame;
6. The DALR$ program will be connected to DOS software system to borrowers can have access to it;
7. In cases where the Director cannot attend mediation or negotiation and the FmHA representative does not have final authority to consummate a settlement, FmHA will agree to continue negotiation/mediation if the State Director does not approve the settlement proposal; and
8. Promote the use of the DALR$ program as a tool for negotiation, not the bottom line. This maximizes the negotiation process and does not create the perception that FmHA has the unilateral authority to terminate negotiations.

In concluding, it is important to note that FmHA has offered a number of valuable approaches in these rules, particularly mediation for states that are not certified. This should be acknowledged, and every effort should be made to reduce any recriminations against FmHA. If FmHA can initiate negotiations/mediation from a non-adversarial approach, the likelihood of meeting the Congressional goals is great. The FmHA staff face a difficult task in implementing these rules, and Congressional support is necessary. Farmers and FmHA can achieve productive outcomes, if the rules create an atmosphere of resolution. This can not occur unless the rules promote flexibility and practical decision making. Congressional assistance is needed to promote this flexibility which will result in a "win/win" approach.

Sincerely,

Micheal L. Thompson

The Conflict Clinic, Inc.

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September 29, 1988

The Honorable David L. Boren, Chairman
Agricultural Credit Subcommittee
Senate Committee on Agriculture, Nutrition and Forestry
#328A Russell Senate Office Building
United States Senate
Washington, DC 20510

Attn.: Ms. Cynthia Molina, Staff

Dear Senator Boren:

As the enclosed testimony shows, the Conflict Clinic, Inc. has been involved in issues arising from the farm credit crisis of the 1980s for over four years. In that time, staff of the Clinic helped the citizens of Iowa develop one of the first statewide farmer-creditor mediation systems in the country and have consulted with legislators, agricultural staff, farmers, lenders and concerned community leaders about farm debt mediation.

On behalf of the Clinic I request that the enclosed testimony be distributed to all members of the Senate Agriculture Committee and that the testimony be entered into the record of the hearing scheduled for tomorrow, September 30, 1988.

The Clinic would be happy to provide additional information or comments on request of the Committee. We commend you, your staff and your subcommittee for its creativity, hard work, and intelligence as you have wrestled with the human and institutional problems created by the farm credit crisis.

Respectfully submitted,

Frank Blechman

Frank Blechman,
Associate

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The Conflict Clinic, Inc.

COMMENTS ON

IMPLEMENTATION OF THE FARM CREDIT ACT OF 1987

BY THE

FARMERS HOME ADMINISTRATION

OF THE U.S. DEPARTMENT OF AGRICULTURE

Prepared for

the Committee on Agriculture, Nutrition and Forestry

of the Senate of the United States

Room 328A Russell Senate Office Building

Washington, DC 20510

September 30, 1988

George Mason University / 4400 University Drive / Fairfax, VA 22030-4444 / (703) 764-6225

The Conflict Clinic, Inc. thanks the Agriculture Committee for this opportunity to submit comments on Implementation of the Farm Credit Act of 1987.

The Conflict Clinic, Inc. is a non-profit conflict resolution group affiliated with the Center for Conflict Analysis and Resolution at George Mason University in Fairfax, Virginia. The Clinic focuses on the study and resolution of complex public disputes. Since 1984, the Clinic has consulted on the development of farmer-creditor mediation systems with concerned citizens and institutions in twelve states, convened three conferences and has written extensively on this subject.

First, we wish to commend the Congress for recognizing the value of Farm Debt Mediation and writing Section V of the 1987 Farm Credit Act explicitly directing the Farmers Home Administration (FmHA) and other Federal providers and guarantors of farm credit to participate in and support the use of mediation in farm credit disputes. The participation of Federal agents and agencies in these processes is already beginning, and the results are already positive.

Second, we commend the conference committee for funding to match, beginning in fiscal year 1989, State support of farmer-creditor mediation programs with Federal dollars. This concrete demonstration of Federal commitment -- while very small in dollar amount -- sends a very strong message of support to states still considering whether they should institute farmer-creditor mediation systems.

Third, we commend the staff of US Department of Agriculture and the Farmers Home Administration for their diligent efforts to understand and implement the 1987 Farm Credit Act. The Farm Credit Act of 1987 imposed many sweeping changes in the structure and management of farm credit programs. FmHA has recognized that each section requires different skills, training, and regulation to implement. With thousands of field staff dispersed in almost every county of the nation, the agency has faced a formidable task redirecting not just the actions but the thinking of these staff. The FmHA staff has exerted an honest effort to find outside expertise to implement difficult parts of the Act.

Particularly, in developing programs relating to Farm Debt Mediation, FmHA staff should be commended for resourcefully and intelligently seeking guidance and advice from Federal, State and private experts in the field. Those resources not only have helped FmHA staff understand the creative problem-solving nature of mediation, but have helped them recognize the flexibility needed to address both the emotional and the financial issues in farm credit disputes.

Comments Submitted by the Conflict Clinic, Inc., Fairfax VA

Implementation is not complete. Applications for certification of state farmer-creditor mediation systems are still pending. Training and support to provide impartial mediation in non-certified states is not yet in place. State directors do not yet have resources to develop consistent participation in mediation. FmHA has found, understandably, that it is very difficult to simultaneously play the different roles required under the 1987 Act: program certifier, loan maker, loan adjuster, financial counselor, impartial convenor, process facilitator and protector of Federal resources. Having recognized that its staff cannot play all of the roles at the same time, FmHA has not yet created systems to separate the roles so that any given staff will play only one at a time. If this separation of roles does not occur, confusion for staff, lenders and borrowers alike will ensue and inefficiency will overtake the system.

The Conflict Clinic urges your continued support of mediation of farm debt issues. Our experience supports your judgement that mediation is an efficient, satisfying way to resolve farmer-creditor disputes.

* * *

Comments Prepared by

Frank Blechman, Associate

The Conflict Clinic, Inc.

Comments Submitted by the Conflict Clinic, Inc., Fairfax VA

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